92-1829

No. 92-

Supreme Court, U.S.
FILED
MAY 19 1993
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

COLGATE-PALMOLIVE COMPANY,
Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal Of The State Of California In And For The Third Appellate District

PETITION FOR A WRIT OF CERTIORARI

JAMES P. KLEIER
Counsel of Record
WALTER HELLERSTEIN
PRENTISS WILLSON, JR.
CLARE M. RATHBONE
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

Counsel for Petitioner

QUESTIONS PRESENTED

1. Whether congressional consent to state action, which precludes judicial scrutiny of such action under the dormant Commerce Clause, may be found in congressional silence.

2. Whether worldwide combined reporting as applied to a U.S.-based multinational group frustrates federal foreign policy, in violation of the Foreign Commerce Clause.

LIST OF PARTIES

The parties are as stated in the caption.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner states that Colgate-Palmolive Company has no parent corporation. Its non-wholly owned subsidiaries are listed in the Appendix to this petition at App. G at 104a.[1]

[1] All references to the Appendix in this petition are denominated "App." followed by a unique letter assigned to each item and a page reference.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT	2
1. Colgate-Palmolive Company's Business	3
2. The Separate Accounting Method	4
3. California's Taxing Scheme	4
4. Opposition to California's Taxing System	5
5. The Assessment	7
6. The Proceedings Below	7
REASONS FOR GRANTING THE WRIT	10
I. IF THE PETITION FOR CERTIORARI IN *BARCLAYS* IS GRANTED, PROPER CONSIDERATION OF THE QUESTIONS THERE PRESENTED COMPELS THAT COLGATE'S PETITION LIKEWISE BE GRANTED	11

II. THE DECISION BELOW IS INCOMPATIBLE WITH PRIOR DECISIONS OF THIS COURT AND, IF LEFT UNDISTURBED, WILL UNDERMINE THE FUNDAMENTAL VALUES OF FREE TRADE THAT THE COMMERCE CLAUSE WAS DESIGNED TO PROTECT 14

III. THE DECISION BELOW PRESENTS AN ISSUE OF PROFOUND NATIONAL AND INTERNATIONAL SIGNIFICANCE THAT MERITS PLENARY CONSIDERATION IN ITS OWN RIGHT 20

CONCLUSION 24

APPENDIX 1a

Appendix A: Order of the California Supreme Court Denying Review, February 18, 1993 ..... 1a

Appendix B: Opinion of the California Court of Appeal, Third Appellate District (on transfer from the California Supreme Court), November 20, 1992..... 2a

Appendix C: Order of the California Supreme Court (transferring case to the California Court of Appeal), June 18, 1992 ..... 27a

Appendix D: Order of the California Supreme Court Granting Review, November 27, 1991 ..... 28a

Appendix E: Opinion of the California Court of Appeal, Third Appellate District, August 20, 1991 ..... 29a

Appendix F: Decision of the Superior Court of California, County of Sacramento, April 19, 1989 ..... 74a

Appendix G: Rule 29.1 List 104a

TABLE OF AUTHORITIES

Page(s)

Cases

Alcan Aluminum Corp. v. Franchise Tax Bd.,
No. 2 Civ. B 065848 (2nd Dist. Cal. 1992), (unpublished decision) *petition for cert. filed*, 61 U.S.L.W. ___ (U.S. May 3, 1993) (No. 92-1751) 3n.2

Barclay's Bank Int'l Ltd. v. Franchise Tax Bd.,
2 Cal. 4th 708, 8 Cal. Rptr. 2d 31, 829 P.2d 279, (3rd Dist. 1992) *on remand*, 11 Cal. App. 4th 1678a (1992), *petition for cert. filed sub nom. Barclays Bank PLC v. Franchise Tax Bd.*, 61 U.S.L.W. 3621 (U.S. Feb. 22, 1993) (No. 92-1384) ..... *passim*

Boston Stock Exchange v. State Tax Comm'n,
429 U.S. 318 (1977) 12

Container Corp. of Am. v. Franchise Tax Bd.,
463 U.S. 159 (1983) ..... *passim*

Itel Containers Int'l Corp. v. Huddleston,
113 S. Ct. 1095 (1993) ..... *passim*

Japan Line, Ltd. v. County of Los Angeles,
441 U.S. 434 (1979) 20,21

Kraft Gen. Foods, Inc. v. Iowa Dep't of Rev. and Finance,
112 S. Ct. 2365 (1992) ..... *passim*

Maine v. Taylor,
477 U.S. 131 (1986) 15,18

Michelin Tire Corp. v. Wages,
423 U.S. 276 (1976) 20

New England Power Co. v. New Hampshire,
455 U.S. 331 (1982) 15

Prudential Ins. Co. v. Benjamin,
328 U.S. 408 (1946) 14

Rodriguez de Quijas v. Shearson/American Express, Inc.,
490 U.S. 477 (1989) 18

South-Central Timber Dev., Inc. v. Wunnicke,
467 U.S. 82 (1984) 15

Sporhase v. Nebraska ex rel. Douglas,
458 U.S. 941 (1982) 15

Wardair Canada, Inc. v. Florida Dep't of Rev.,
477 U.S. 1 (1986) ..... *passim*

Wyoming v. Oklahoma,
112 S. Ct. 789 (1992) 15

Zee Toys, Inc. v. County of Los Angeles,
85 Cal. App. 3d 763, 149 Cal. Rptr. 750 (2nd Dist. 1978), *aff'd by an equally divided court sub nom. Sears, Roebuck & Co. v. County of Los Angeles*, 449 U.S. 1119 (1981) 13

Zschernig v. Miller,
389 U.S. 429 (1986) 22n.14

Constitutional Provisions and Statutes

U.S. Const., art. I, § 8, cl. 3 2

26 U.S.C. § 482 ..... 4n.5,n.6

28 U.S.C. § 1257(a) 2

Cal. Rev. & Tax. Code (West 1992) § 25101 2,4

Other Authorities

Treasury Department's Model Income Tax Treaty of June 16, 1981, arts. 7(2), 9(2), *reprinted in* 1 Tax Treaties (CCH) ¶ 211 (1992) 4n.6

OECD Model Convention For The Avoidance Of Double Taxation With Respect To Taxes On Income And Capital, arts. 7(2), 9(1) (1992), *reprinted in* 1 Tax Treaties (CCH) ¶ 201 (1992) 4n.6

Section 54 of and Schedule 13 to the Finance Act of 1985, reenacted as Section 812-815 of the Income and Corporations Taxes Act, 1988, House Bill (1985) 5n.8

House of Commons Official Report, *Parliamentary Debates* (Hansard), 1036 (9 July 1985) (statement of John Moore) 6n.9

Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation 5n.7

Statement of Canada before the United States Worldwide Unitary Taxation Working Group 5n.7

Submission of the Australian Government to the U.S. Task Force on Unitary Taxation dated January 4, 1984 ..... 5n.7

Diplomatic note dated November 24, 1978, between George S. Vest, Assistant Secretary of State for European Affairs, and Françoise de Laboulaye, Ambassador of France 5n.7

Statement of the President of the United States dated November 8, 1985 ..... 6n.10,22

Letter from George Shultz, Secretary of State, to the Governor of California dated January 30, 1986 ..... 6n.10,22

Letter from James A. Baker III, Secretary of the Treasury, to Senator Bob Packwood, Chairman of the Senate Finance Committee dated March 5, 1986 ..... 6n.10

Letter from Nicholas Brady, Secretary of the Treasury, to Reuben Mark, Chairman and Chief Executive Officer of Colgate dated September 13, 1991, attached to Colgate's Petition for Review to the California Supreme Court dated September 30, 1991 6,22

Remarks of Senator Matsunga, 124 Cong. Rec. 18,669 (1978) 17n.12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-

COLGATE-PALMOLIVE COMPANY,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

Petition for a Writ of Certiorari to the Court of Appeal of the State of California In and for the Third Appellate District

---

PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the California Court of Appeal is reported at 10 Cal. App. 4th 1768, 13 Cal. Rptr. 2d 761 (3d Dist. 1992) (App. B at 2a-26a). An earlier opinion of the Court of Appeal in the same case was reported at 233 Cal. App. 3d 855, 284 Cal. Rptr. 780 (3d Dist. 1991) (App. E at 29a-73a). The opinion of the California Superior Court (App. F at 74a-103a) is unreported.

JURISDICTION

The judgment of the California Court of Appeal, Third Appellate District, was entered on November 20, 1992. App. B at 26a. The California Supreme Court denied review on February 18, 1993. App. A at 1a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article 1, section 8, clause 3 of the United States Constitution, the Commerce Clause, U.S. Const., art. I, § 8, cl. 3, provides: "The Congress shall have power ... [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

California Revenue & Taxation Code, Cal. Rev. & Tax. Code § 25101 (West 1992) provides: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). ..."

STATEMENT

This case, like *Barclays Bank Int'l Ltd. v. Franchise Tax Bd.*, 2 Cal. 4th 708, 8 Cal. Rptr. 2d 31, 829 P.2d 279 (1992), *on remand*, 11 Cal. App. 4th 1678a (3d Dist. 1992), *petition for cert. filed sub nom. Barclays Bank PLC v. Franchise Tax Bd.*, 61 U.S.L.W. 3621 (U.S. Feb. 22 1993) (No. 92-1384), raises issues of profound national and international significance regarding the states' power to require multinational corporations to report their income on a worldwide combined basis.[2] Specifically, this case raises the question whether Congress, by its silence, may be taken to have consented to the states' use of worldwide combined reporting, thereby precluding any inquiry into its constitutionality under the dormant Commerce Clause; and, if not, whether worldwide combined reporting frustrates federal foreign policy in violation of the Commerce Clause. The petitioner in *Barclays* raises these questions in the context of a group of foreign and domestic corporations with a foreign parent (a foreign-based multinational group), while this case involves the same questions in the context of a group of foreign and domestic corporations with a domestic parent (a U.S.-based multinational group). The facts regarding these questions, which have been stipulated, are not in dispute.

1. Colgate-Palmolive Company's Business

Colgate-Palmolive Company is a Delaware corporation with its corporate headquarters in New York. During the years in question, 1970-73, Colgate-Palmolive Company and its subsidiaries doing business in the United States (hereinafter "Colgate"), were engaged principally in the manufacture and distribution of household and personal hygiene products. Colgate's operations extended throughout the United States, including California, where it manufactured and sold products. In addition to its United States operations, Colgate owned approximately 75 foreign subsidiaries that operated in 53 foreign countries.[3] Joint Stipulation, *Colgate-Palmolive Co. v.*

---

[2] Another certiorari petition recently filed in this Court also raises these issues. *Alcan Aluminum Corp. v. Franchise Tax Bd.*, No. 2 Civ. B 065848 (2d Dist. Cal. 1992) (unpublished decision), *petition for cert. filed*, 61 U.S.L.W. __ (U.S. May 3, 1993) (No. 92-1751).

[3] Colgate does not challenge here the trial court's conclusion that Colgate was engaged in a worldwide unitary business with its foreign subsidiaries other than certain subsidiaries acquired in 1972 and 1973.

Franchise Tax Bd., No. 319715 (Cal. Super. Ct.) at ¶ 8.[4] These foreign subsidiaries, which were likewise engaged in the manufacture and distribution of household and personal hygiene products, operated *exclusively* in countries outside the United States. They conducted no business in California or in any other state and sold no products in California or any other state.

2. The Separate Accounting Method

The United States, along with the majority of other nations of the world, uses the "arm's-length" or "separate accounting" method to allocate the income of a multinational group among the different jurisdictions in which it operates.[5] Under this method, the various members of a multinational enterprise are viewed as separate from one another, and the income of any particular member of a group is determined on the basis of the internal accounting records of that member. Affiliates are required to report intercompany transactions on an arm's-length basis, as if dealing with unrelated entities in the marketplace. Separate accounting is the method uniformly adopted in tax treaties between the United States and foreign nations, as well as the standard that the United States has adopted in its internal tax laws.[6]

3. California's Taxing Scheme

California's worldwide combined reporting method of taxation (Cal. Rev. & Tax. Code § 25101) treats as a single enterprise all of the worldwide affiliates of a multinational group that are engaged in a unitary business. The resulting worldwide income is apportioned between California and the rest of the world based on a three-factor formula of property, payroll and sales. Thus, for the years in question, Colgate's California property was divided by the worldwide property of Colgate and all of its foreign subsidiaries. Similar worldwide fractions were obtained for payroll and sales. The average of the three was then applied against the worldwide combined taxable income of Colgate and all of its foreign subsidiaries to apportion part of it to California.

[4] All subsequent references to the Joint Stipulation in this case are denominated "Stip." followed by a paragraph reference.

[5] *See* 26 U.S.C. § 482.

[6] *See* Treasury Department's Model Income Tax Treaty of June 16, 1981, arts. 7(2), 9(2), *reprinted in* 1 Tax Treaties (CCH) ¶ 211 (1992); OECD Model Convention for the Avoidance Of Double Taxation with Respect to Taxes on Income and Capital, arts. 7(2), 9(1), (1992), *reprinted in* 1 Tax Treaties (CCH) ¶ 201 (1992). *See also* 26 U.S.C. § 482.

4. Opposition to California's Taxing System

Since its inception, California's use of the worldwide combined reporting method of taxation has been the focus of steadily increasing national and international opposition because of its disregard of the established international norm of tax accounting. On the international front, foreign governments have repeatedly protested California's use of the taxing method.[7] Indeed, its continued use prompted the United Kingdom, in 1985, to enact retaliatory legislation.[8] This legislation gives the United Kingdom the authority to deny the shareholders' tax credit (a credit that the United Kingdom gives on dividends paid by U.K. subsidiaries to their U.S. parents) to U.S. parent corporations with a presence in states that

[7] *See, e.g.*, Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation, Stip. ¶ 38a; statement of Canada before the United States Worldwide Unitary Taxation Working Group, Stip. ¶ 38c; submission of the Australian Government to the U.S. Task Force on Unitary Taxation, dated January 4, 1984, Stip. ¶ 38d; diplomatic note dated November 24, 1978, between George S. Vest, Assistant Secretary of State for European Affairs, and Francoise de Laboulaye, Ambassador of France, Stip. ¶ 48.

[8] Section 54 of and Schedule 13 to the Finance Act of 1985, reenacted as Sections 812-815 of the Income and Corporations Taxes Act, 1988.

use worldwide combined reporting.[9] Colgate would be directly affected by this legislation.

Similarly, on the domestic front, it has been the expressed policy of the federal government to oppose states' use of the worldwide combined reporting method of taxing multinational corporations because of that taxing method's impact upon relations with foreign nations. That opposition has been expressed in statements issued by the President, the Secretary of State and the Secretary of the Treasury.[10] The United States has appeared as amicus curiae to support the taxpayer in *Barclays* in all three California courts. Moreover, the federal government has issued statements, specific to this case, condemning worldwide combined reporting as applied to U.S.-based multinational taxpayers. For example, in a letter to Colgate, then-United States Secretary of the Treasury Nicholas Brady wrote on behalf of the Departments of Treasury, Justice and State and the U.S. Trade Representative that "we are equally opposed to the use of worldwide unitary apportionment to determine the income of domestic-parent multinational corporations and that of foreign-parent multinational corporations" (hereinafter "Secretary Brady's Letter").[11]

---

[9] House of Commons Official Report, *Parliamentary Debates* (Hansard), 1036 (9 July 1985) (statement of John Moore).

[10] *See, e.g.*, Statement of the President of the United States, dated November 8, 1985, Stip. ¶ 31, App. F at 90a, 100a; letter from George Shultz, Secretary of State, to the Governor of California dated January 30, 1986, Stip. ¶ 33, App. F at 90a, 100a.; letter from James A. Baker III, Secretary of the Treasury, to Senator Bob Packwood, Chairman of the Senate Finance Committee, dated March 5, 1986, Stip. ¶ 32, App. F at 101a.

[11] *See* Letter from Nicholas Brady, Secretary of the Treasury, to Reuben Mark, Chairman and Chief Executive Officer of Colgate, dated September 13, 1991, attached to Colgate's Petition for Review to the California Supreme Court, dated September 30, 1991.

5. The Assessment

Colgate timely filed California franchise tax returns for the income years 1970 through 1973, reporting the income earned from its foreign operations on a separate accounting basis. The Franchise Tax Board determined that Colgate's tax should be determined on the basis of worldwide combined reporting. Colgate paid the additional tax owing under the Franchise Tax Board's method of computation and filed claims for refund which were denied.

6. The Proceedings Below

a. How the Federal Questions Were Raised and Passed On Below

In its complaint and briefs in the California Superior Court, in its briefs in the California Court of Appeal, and in its briefs in the California Supreme Court, Colgate contended that the Commerce Clause precluded California from using the worldwide combined method of taxation. Colgate also raised other constitutional objections below which it is not pressing before this Court. The California Superior Court and the California Court of Appeal explicitly noted and ruled on Colgate's Commerce Clause claims. App. F at 102a; App. B at 26a. The California Supreme Court, after remanding the case back to the Court of Appeal (App. C at 27a), subsequently denied Colgate's petition for review. App. A at 1a.

b. The Decisions Below

i. California Superior Court

The California Superior Court, after reviewing all the evidence of the federal government's policy towards worldwide combined reporting, found that it did indeed interfere with United States foreign policy. In reaching this conclusion, the trial court rejected the contentions of the Franchise Tax Board that Congress had expressly approved of California's method

of taxation, thereby rendering dormant Commerce Clause analysis unnecessary. On the contrary, the trial court found as a factual matter "that the executive branch of the federal government has clearly expressed a federal policy supporting the principle of water's edge taxation of multinational corporations and disapproving the world-wide unitary method ... and that the legislative branch has not expressed a contrary policy." App. F at 97a-98a.

Moreover, the trial court found that the policy of the United States was the same whether the worldwide unitary method of taxation was applied to U.S.-based multinational groups (such as Colgate) or to foreign-based multinational groups (such as the petitioner in *Barclays*). As noted by the trial court, "[t]he condemnation of the worldwide unitary method applies to all instrumentalities of foreign commerce, not just foreign based corporate groups." App. F at 90a.

In reaching its conclusion, the trial court found that this case differed dramatically in its factual posture from *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). In *Container*, this Court addressed the same issue, that is, the constitutionality of worldwide combined reporting, but found that it had no evidence of a clear statement by the federal government regarding the impact of worldwide combined reporting on federal foreign policy. *Container*, 463 U.S. at 195 n.33. Here, by contrast, the trial court found that the evidence which was lacking in *Container* had been supplied by the Executive Branch and introduced by Colgate. App. F at 90a. In light of this finding, the trial court held that California's method of taxation violated the Foreign Commerce Clause.

ii. Court of Appeal (First Opinion)

The Court of Appeal reversed. The court agreed with the trial court that Congress had not expressed a policy in favor of California's method of taxation, thus necessitating analysis under the dormant Commerce Clause. However, although it

had held in *Barclays* that worldwide combined reporting violated the Foreign Commerce Clause as applied to a foreign-based multinational group, the court stated that it would not invalidate the tax under the Foreign Commerce Clause without an explicit statement of federal hostility towards worldwide combined reporting in the context of a U.S.-based multinational group. The Court of Appeal justified its conclusion by noting repeatedly that the federal government had been notified about this case by counsel for Colgate and yet "the executive branch has done nothing here to make its position known" in this case. App. E at 57a.

iii. California Supreme Court

Colgate's petition for review to the California Supreme Court was based largely on statements by the federal Executive Branch condemning worldwide combined reporting as applied to Colgate, which were released after the Court of Appeal indicated that previous statements were insufficient. The California Supreme Court granted Colgate's petition for review. App. D at 28a. Before the case was set for argument, however, the court issued its decision in *Barclays*. In addressing the constitutionality of worldwide combined reporting as applied to a foreign-based multinational group, the court did not deal at all with the policy statements of the Executive Branch, and instead found that any inquiry into the validity of worldwide combined reporting under the Foreign Commerce Clause was precluded by Congress's consent to the state taxation at issue. The court found this consent, not in any affirmative congressional action, but rather in what the court referred to as "the din of a 'governmental silence.'" *Barclays*, 2 Cal. 4th at 732. Relying on *Wardair Canada, Inc. v. Florida Dep't of Rev.*, 477 U.S. 1 (1986), the court held that "recent foreign commerce clause jurisprudence reflects a diminution in the reach of the dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, governmental silence may constitute a ratification of state

taxation of foreign commerce, rendering a dormant analysis inapposite." *Id.* at 714.

Since the five factors that the court found sufficient to constitute congressional consent to states' use of worldwide combined reporting in *Barclays* were also present in this case, the court remanded this case to the Court of Appeal for it to reconsider its prior opinion in light of the California Supreme Court's decision in *Barclays*. App. C at 27a.

iv. Court of Appeal (Second Opinion)

On remand, the Court of Appeal recognized that "for purposes of whether *Wardair* applies in light of the factors cited by the [Franchise Tax] Board, there is no distinction between this case and *Barclays*." App. B at 18a. The court therefore found itself "obligated to adopt the analysis in *Barclays* regarding *Wardair*'s applicability" (App. B at 18a) and held that Congress had consented to the states' application of worldwide combined reporting to domestic-based groups.

v. California Supreme Court

On February 18, 1993, the California Supreme Court denied Colgate's petition for review of the revised opinion of the Court of Appeal. App. A at 1a.

REASONS FOR GRANTING THE WRIT

The decision of the California Court of Appeal warrants review by this Court for three compelling reasons. First, as noted above, the issues in this case are intimately related to those raised by the petition for certiorari filed in *Barclays*. If the petition for certiorari is granted in *Barclays*, proper consideration of the issues raised by that petition, including the ramifications for U.S.-based multinational groups raised in this petition, requires that this petition likewise be granted. Second, the Court of Appeal's resolution of the congressional consent and Foreign Commerce Clause issues raised by this case is in-

compatible with prior decisions of this Court and, if left undisturbed, would upset the constitutional balance between state and federal authority that the Framers created. Third, the questions raised by this case have profound national and international significance that merits plenary consideration in its own right.

I. IF THE PETITION FOR CERTIORARI IN *BARCLAYS* IS GRANTED, PROPER CONSIDERATION OF THE QUESTIONS THERE PRESENTED COMPELS THAT COLGATE'S PETITION LIKEWISE BE GRANTED

Proper consideration of the questions presented in *Barclays* compels that Colgate's petition be granted. The issues raised by the petition in *Barclays* — issues concerning the constitutionality of worldwide combined reporting under the Commerce Clause and the criteria for determining whether Congress has consented to state action under the Commerce Clause — are the issues that lie at the heart of Colgate's petition. If the *Barclays* petition is certworthy, and Colgate is confident that the Court will determine that it is, then it follows that Colgate's petition should likewise be granted so that the ultimate disposition of the issues shared by the two cases will be the same.

Both the petition in *Barclays* and this petition raise *exactly* the same issue regarding whether Congress has consented to California's use of worldwide combined reporting. The congressional silence which was viewed by the court below as consent to California's method of worldwide combined reporting is an equally complete silence for both U.S.-based and foreign-based multinational groups. The instances of failure to act relied upon by the California courts to imply consent are identical in this case and *Barclays*. *See, e.g.*, App. B at 16a; *Barclays*, 2 Cal. 4th at 733-41.

There is, to be sure, a difference between the two cases: *Barclays* involves a foreign-based multinational group, while this case involves a U.S.-based multinational group. This difference, however, merely reinforces the considerations that militate in favor of granting Colgate's petition in this case. Simply stated, the Commerce Clause requires that the foreign commerce conducted by a U.S.-based multinational group be taxed in the same way as the foreign commerce conducted by a foreign-based multinational group. Thus, under the Commerce Clause, if California cannot apply worldwide combined reporting to the taxpayer in *Barclays*, California cannot use worldwide combined reporting to tax Colgate.

This Court has held that it is unconstitutional under the Commerce Clause to prefer one form of "protected" commerce over another. This issue was expressly addressed in *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977), in which the Court struck down a tax statute which discriminated between two types of transactions, both of which were in interstate commerce. The Court expressly rejected the apparent view of the New York Court of Appeals that discrimination between two kinds of transactions in interstate commerce was permissible. *Id.* at 333. In particular, the Court disapproved discrimination between different forms of protected commerce where such discrimination would result in a "diminution of free competition," which the Court viewed as "wholly inconsistent with the free trade purpose of the Commerce Clause." *Id.* at 336. If California is permitted to apply worldwide combined reporting to U.S.-based multinational groups such as Colgate and its affiliates, but not to foreign-based multinational groups such as the one involved in *Barclays*, the resulting competitive advantage to foreign-based multinational groups would seriously undermine the level playing field for different forms of protected commerce which is the essence of the free trade purpose of the Commerce Clause.

The necessity for equal treatment of all forms of protected commerce was reemphasized last term when the Court struck down a state tax scheme which favored interstate over foreign commerce. *Kraft Gen. Foods, Inc. v. Iowa Dep't of Rev. and Finance*, 112 S. Ct. 2365 (1992). In addition, in *Zee Toys, Inc. v. County of Los Angeles*, 85 Cal. App. 3d 763, 149 Cal. Rptr. 750 (2d Dist. 1978), *aff'd by an equally divided court sub nom. Sears, Roebuck & Co. v. County of Los Angeles*, 449 U.S. 1119 (1981), the California Court of Appeal, in a decision that was affirmed by this Court, explained:

> Discrimination between (1) interstate transactions and foreign transactions cannot be distinguished from (2) discrimination between two types of interstate transactions. Both interstate and foreign transactions are brought within the control of Congress by the same clause of the United States Constitution.

Zee Toys, 85 Cal. App. 3d at 775. The Constitution will therefore not permit discriminatory taxation of foreign commerce conducted through U.S.-based groups in favor of foreign commerce conducted through foreign-based groups.

Although the Court found it unnecessary to reach this issue in *Container*, several members of the Court made it clear that invalidating worldwide combined reporting as applied only to foreign-based multinationals would be "unacceptable" because "[i]t would leave California free to discriminate against a Delaware corporation in favor of an overseas corporation." *Container*, 463 U.S. at 203 (Powell, J., dissenting).

In short, if California's worldwide combined reporting tax scheme as applied to foreign-based multinational groups violates the Commerce Clause, then application of the tax scheme to domestic-based multinational groups such as Colgate cannot withstand constitutional scrutiny. In light of this fact, the proper disposition of *Barclays* and that of the instant case are inextricably intertwined. If this Court grants the petition in *Barclays*, it should grant the petition in this case in order to avoid the creation of a constitutionally unacceptable scheme

whereby worldwide combined reporting is declared unconstitutional as regards foreign-based multinational groups, but remains constitutional as applied to domestic-based groups.

II. THE DECISION BELOW IS INCOMPATIBLE WITH PRIOR DECISIONS OF THIS COURT AND, IF LEFT UNDISTURBED, WILL UNDERMINE THE FUNDAMENTAL VALUES OF FREE TRADE THAT THE COMMERCE CLAUSE WAS DESIGNED TO PROTECT

The decision below rests squarely on the California Supreme Court's determination in *Barclays* that Congress has consented to the states' use of worldwide combined reporting, thereby precluding any inquiry into its defensibility under the dormant Commerce Clause. However, the Court of Appeal's holding, which flows directly from the California Supreme Court's opinion that congressional consent to state action may be gleaned from congressional silence, has created an irreconcilable conflict with prior decisions of this Court.

It is well-established that when Congress exercises its power under the Commerce Clause to consent to a state law, any question of the validity of that state law under the dormant Commerce Clause disappears, even though that state law might otherwise burden interstate or foreign commerce. As this Court recognized in *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946), because Congress has plenary power over the channels of interstate commerce, "Congress may keep the way open, confine it broadly or closely, or close it entirely," *id.* at 434, subject only to the limitations that the Constitution imposes on Congress's own power. This includes, of course, the power to authorize state laws that discriminate against or otherwise burden interstate commerce, laws that would be struck down in the absence of congressional action consenting to them. *Id.*

Recognizing the considerable consequences that emanate from a finding of congressional consent, this Court has consistently required that Congress manifest its consent to state law through unambiguous affirmative action. Thus the Court has repeatedly stressed that "[a]n unambiguous indication of congressional intent is required before a federal statute will be read to authorize otherwise invalid state legislation" and provide an "exemption from Commerce Clause scrutiny." *Maine v. Taylor*, 477 U.S. 131, 138-39 (1986); *see also Wyoming v. Oklahoma*, 112 S. Ct. 789, 802 (1992) ("Congress must manifest its unambiguous intent before a federal statute will be read to permit or to approve ... a violation of the Commerce Clause ..."); *South-Central Timber Dev. Inc. v. Wunnicke*, 467 U.S. 82, 91-92 (1984) (rejecting "'implicit approval' theory" of congressional consent and reaffirming "[a] rule requiring a clear expression of approval by Congress"); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982) ("In the instances in which we have found such [congressional] consent, Congress' '"intent and policy" to sustain state legislation from attack under the Commerce Clause' was '"expressly stated."'"); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 343 (1982) ("[W]hen Congress has not 'expressly stated its intent and policy' to sustain state legislation from attack under the Commerce Clause, ... we have no authority to rewrite its legislation based on mere speculation as to what Congress 'probably had in mind.'").

Despite this well-established body of case law, the California Court of Appeal found itself "obligated" to adopt the California Supreme Court's decision in *Barclays* that Congress has consented to California's use of worldwide combined reporting. Moreover, the California Supreme Court found this consent not in unambiguous affirmative action, but rather in "the din of a 'governmental silence.'" *Barclays*, 2 Cal. 4th at 732. The court justified its novel approach by relying almost exclusively on this Court's decision in *Wardair*, finding that case to represent "if not a change of course in the high

court's dormant commerce clause jurisprudence, at least a retrenchment in its scope." *Barclays*, 2 Cal. 4th at 731. The California Supreme Court's conclusion that congressional silence and inaction can form the basis of congressional consent, however, cannot be reconciled with *Wardair*, or with decisions of this Court prior to and following *Wardair*. Indeed, *Wardair* itself found consent on the basis that "the Federal Government has not remained silent" but rather "has affirmatively decided to permit" the state taxation at issue. *Wardair*, 477 U.S. at 12.

Moreover, the inaction of Congress in this case is inconsistent with any plausible view of consent and certainly does not establish the factual basis for consent found in *Wardair*. Whereas the Court in *Wardair* found consent in a series of international agreements that specifically considered the state taxation at issue, the California Supreme Court and, by following it, the court below found consent by implication in a series of congressional inactions and failures to act. In *Wardair*, the Court relied on an international agreement that expressly prohibited state taxation of certain fuel and thereby reflected Congress's consent to the imposition of other state taxes on aviation fuel, including the tax at issue. The Court also considered a second resolution that addressed the question of state taxation of aviation fuel. On the basis of these foundational documents, which specifically considered the question of subnational taxation, the Court found that subsequent agreements, which precluded only national taxes on aviation fuels, revealed a conscious decision to permit the state taxes at issue.

This affirmative action may be contrasted with the five items of inaction which the California Supreme Court and the court below identified as signifying congressional consent to the use of worldwide combined reporting. Four of the items relied upon do not even mention the question of states' use of worldwide combined reporting, expressing no more than a preference for separate accounting at the federal level. The single item which even addresses the question of states' use of

worldwide combined reporting is the failure to obtain the two-thirds vote necessary to ratify a treaty containing a provision prohibiting states' use of worldwide combined reporting. However, the treaty with the provision included received a favorable vote of 49 to 32, falling only five votes short of the required two-thirds vote necessary for the ratification of the treaty. A majority of Senators therefore voted to *support* the provision, negating any possible inference of consent from the failure to act.[12] Moreover, petitioner submits that a *senatorial* failure to ratify a treaty cannot be held up as an indicator of *congressional* consent for states' use of worldwide combined reporting.

Finally, the five factors found to constitute congressional consent by the California Supreme Court and the court below all existed prior to this Court's decision in *Container*. Nevertheless, despite the presence of these factors at that time, this Court engaged in dormant Commerce Clause analysis and implicitly concluded that Congress had not consented to worldwide combined reporting.

The Court of Appeal's attack on this Court's criteria for determining congressional consent warrants review. First, important policies of free trade protection surround this Court's insistence on clear expressions of congressional consent, and these policies will be jeopardized if review is not granted. The Court has protected the core value of free trade within a national market in its numerous decisions under the dormant Commerce Clause, striking down state laws that burden interstate commerce. But to expose interstate or foreign commerce to burdensome state legislation without the clearest signal from Congress of its intent to strip such commerce of the protections it ordinarily enjoys would undermine our constitu-

---

[12] Indeed, the failure to ratify the treaty with the provision included reflects more the concern of the Senate that the treaty ratification process was not the appropriate forum to consider such a curb on states' powers. *See* Remarks of Senator Matsunga, 124 Cong. Rec. 18,669 (1978).

tional scheme. "Absent 'a clear expression of approval by Congress,' any relaxation in the restrictions on state power otherwise imposed by the Commerce Clause unacceptably increases 'the risk that unrepresented interests will be adversely affected by restraints on commerce.'" *Maine v. Taylor*, 477 U.S. at 139.

Second, there is no justification either in constitutional policy or in this Court's precedents for the extraordinary suggestion of the court below that congressional silence constitutes consent under the Commerce Clause. As we have explained above, both policy and law are to the contrary, and the California court has advanced no sound reason for abandoning them. In any event, it is clearly the prerogative of this Court — not a state court — to determine whether the Court's decisions should be overturned. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

Third, even if there are some suggestions in *Wardair* that the "negative implications," 477 U.S. at 10, of affirmative congressional action can lay the evidentiary predicate for a finding of congressional consent to state law, these suggestions do not license a state court to base a finding of consent on the negative implications of congressional *inaction*, which is what the California court did here. The Court in *Wardair* explicitly declared that it was drawing negative inferences from governmental action — not governmental omission — in finding that Congress had affirmatively consented to the tax at issue. The suggestion that *Wardair* "represents, if not a change of course in the high court's dormant foreign commerce clause jurisprudence, at least a retrenchment in its scope," *Barclays*, 2 Cal. 4th at 731, is unfounded. *Wardair* is woven from the same thread as the Court's earlier decisions involving congressional consent, as well as from its later decisions. Indeed, the claim that there has been a "retrenchment" in the Court's Foreign Commerce Clause jurisprudence is belied by the Court's most recent decisions in this domain. *See Itel Containers Int'l Corp. v.*

Huddleston, 113 S. Ct. 1095 (1993);[13] *Kraft*, 112 S. Ct. 2365 (1992). In any event, insofar as one might read *Wardair* as relaxing the standards for finding congressional consent to state law, *Wardair*, 477 U.S. at 18-20 (Blackmun, J., dissenting), it is incumbent upon this Court to clarify those standards so they will not be subject to the misreading that they received below.

Finally, the implications of the decision below are so destructive of the free trade purposes underlying the Commerce Clause, which provides the basis for this Court's dormant Commerce Clause jurisprudence, that it should not be left undisturbed. Under the California court's analysis, "silence" becomes a basis for inferring consent to state law under the Commerce Clause. Yet it is this very "silence" that has for two centuries been the basis for the Court's dormant Commerce Clause jurisprudence. If congressional silence can justify a finding of congressional consent to state laws, then there may well be no room for the dormant Commerce Clause to operate at all. At a minimum, its scope may be substantially narrowed, and courts will have to distinguish between the kinds of "silence" that warrant a dormant Commerce Clause inquiry and those that preclude judicial scrutiny of state law altogether. These questions are indisputably worthy of this Court's attention.

---

[13] In *Itel*, this Court considered whether a sales tax on containers violated the Foreign Commerce Clause despite the existence of two international Container Conventions to which the U.S. was a signatory, and federal regulations. Both the Conventions and the federal regulations restricted taxation on international containers. Far from reasoning that Congress, by prescribing certain taxes on containers, had implicitly consented to state taxation on those containers, this Court readily engaged in dormant Commerce Clause analysis.

III. THE DECISION BELOW PRESENTS AN ISSUE OF PROFOUND NATIONAL AND INTERNATIONAL SIGNIFICANCE THAT MERITS PLENARY CONSIDERATION IN ITS OWN RIGHT

Wholly apart from the conflict that the decision below has created with decisions of this Court, the decision warrants this Court's review in its own right. The precise scope of the constitutional restraints on the states' power to impose a tax that conflicts with the clear, expressed policy of the federal government is a question of profound significance for our relations with foreign nations that calls for this Court's attention and guidance. This Court has recognized that "the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce." *Kraft*, 112 S. Ct. at 2370 (citing *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 445-46(1979)). Foreign commerce merits broader protection because "matters of concern to the entire Nation are implicated," *Kraft*, 112 S. Ct. at 2370 (quoting *Japan Line*, 441 U.S. at 448), including "sensitive matters of foreign relations and national sovereignty." *Japan Line*, 441 U.S. at 456. Nowhere are those sensitive matters of foreign relations more at issue than in this case.

In a series of decisions handed down during the late 1970s and early 1980s, this Court delineated the Commerce Clause limitations on the states' power to tax foreign commerce. Thus, these decisions established that a state tax cannot survive scrutiny under the Foreign Commerce Clause if the tax would "impair federal uniformity in an area where federal uniformity is essential," *Japan Line*, 441 U.S. at 448, or prevent "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* at 451 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976)). In *Container*, this Court established that a state tax will violate the "one voice" standard of the Foreign Commerce Clause if that tax either implicates foreign policy issues that

must be left to the federal government or violates a *clear federal directive*. *Container*, 463 U.S. at 194. Thus, the question before this Court is whether a statement from the federal government opposing California's method of taxing multinational corporations, made in the context of federal foreign policy concerns, evidences a violation of the "one voice" standard.

The question whether California's inclusion of foreign operations in a single unitary business with United States operations violates the Commerce Clause through its interference with federal foreign policy came before the United States Supreme Court in *Container*. However, at the time that this Court decided *Container*, the Court found that it did not have before it a clear statement by the Executive Branch regarding the impact of California's method of taxation on federal foreign policy. This Court explained the reason for its conclusion that it could not determine the position of the Executive Branch as follows:

> The Solicitor General did submit a memorandum opposing worldwide formula apportionment by a State in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, No. 81-349, a case that was argued last Term, and carried over to this Term. Although there is no need for us to speculate as to the reasons for the Solicitor General's decision not to submit a similar memorandum or brief in this case ... there has been no indication that the position taken by the Government in *Chicago Bridge & Iron Co.* still represents its views, or that we should regard the brief in that case as applying to this case.

Container, 463 U.S. at 195 n.33. The Court thus indicated its reluctance to find that California's method of taxation impermissibly interferes with federal foreign policy, in the absence of a clear statement of the position of the federal government.

More recently, the Court distinguished the worldwide combined reporting method of taxation which it upheld in *Container* from the ad valorem tax which it struck down in *Japan Line*, on the basis that "'in [*Container Corp.*], unlike *Japan Line*, the Executive Branch ha[d] decided not to file an *amicus curiae* brief in opposition to the state tax.'" *Itel*, 113 S. Ct. at

1103 (quoting *Container*, 463 U.S. at 195). The Court therefore concluded that "the Government's nonintervention suggested that the tax presented no serious threat to United States foreign policy." *Id.* at 1104.

The missing evidence which was crucial in *Container* has now been supplied by the federal government. In response to a specific request from Colgate that the federal government state its position on worldwide combined reporting and make that position explicit beyond doubt in the context of domestic-based multinational groups, the federal government issued the following response:

> As a tax policy matter, we are equally opposed to the use of worldwide unitary apportionment to determine the income of domestic-parent multinational corporations and that of foreign-parent multinational corporations.

Secretary Brady's Letter.[14]

Moreover, this statement does not represent a new policy of the federal government. In fact, this statement does no more than elaborate on the plain language of prior Executive Branch statements which clearly condemn the application of worldwide combined reporting to all multinational groups. On November 8, 1985, the President issued a statement instructing the Secretary of the Treasury to pursue through legislation, and the Attorney General to pursue in appropriate cases in litigation, the federal policy that multinationals be taxed by states only on income derived from the territory of the United States. *See* App. F at 90a. Similarly, on January 30, 1986, Secretary of State George Shultz wrote to the Governor of California that "employment of worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states." *See*

---

[14] This Court has frequently recognized Executive Branch letters as valid evidence of the policy of the federal government. *See, e.g., Zschernig v. Miller*, 389 U.S. 429 (1968).

App. F at 91a. Since that time, the federal government has pursued its opposition to worldwide combined reporting through many efforts, including appearing as *amicus curiae* for the taxpayer in *Barclays* in each of the California courts.

In *Itel*, in holding that the Tennessee sales tax at issue did not violate the Foreign Commerce Clause, this Court found the view of the United States government determinative. Indeed, citing *Wardair*, this Court stated that it would be turning dormant Commerce Clause "'upside down ... to apply it in a way as to *reverse* the policy that the Federal Government has elected to follow.'" *Itel*, 113 S. Ct. at 1105 (citing *Wardair*, 477 U.S. at 12). Similarly, if this Court allows the lower decision to stand, the policy of the federal government will have effectively been reversed, with the resulting instability both nationally and internationally that will follow from that reversal.

Quite simply, therefore, *Container* held that, in the absence of a clear statement of the position of the Executive Branch, the Court would not on its own invalidate California's tax. *Container* did not decide the limits on a state's power to tax multinational corporations in the face of direct federal government opposition to that taxing method. These are the questions we are asking this Court to review.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,
James P. Kleier
Counsel of Record
Walter Hellerstein
Prentiss Willson, Jr.
Clare M. Rathbone
Morrison & Foerster
345 California Street
San Francisco, CA 94104
(415) 677-7000
Counsel for Petitioner

APPENDIX A

COLGATE-PALMOLIVE COMPANY,
Respondent,

v.

FRANCHISE TAX BOARD,
Appellant.

No. S023147.

Supreme Court of the State of California,
in Bank.

Feb. 18, 1993.

Respondent's petition for review DENIED.

LUCAS
Chief Justice

Filed February 18, 1993

Robert Wandruff, Clerk
Deputy

APPENDIX B

COLGATE-PALMOLIVE COMPANY,
Plaintiff and Respondent,

V.

FRANCHISE TAX BOARD,
Defendant and Appellant.

No. C007044.

Court of Appeal of the State of California,
Third Appellate District.

Nov. 20, 1992

DAVIS, J.

The principal issue in this appeal is whether California's worldwide unitary method of taxation (based on Rev. & Tax. Code, §§ 25101, 25120-25139), as applied to domestic-parent unitary corporate groups, is unconstitutional under the foreign commerce clause of the United States Constitution. (U.S. Const., art. I, § 8, cl. 3.)[1] Using the dormant foreign commerce

---

[1] During the tax years at issue (1970-1973), Revenue and Taxation Code section 25101 provided in pertinent part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter);..."

California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA), is contained in Article 2. That Act provides for formula apportionment of the net income from business activities both within and

Footnote continued...

clause analytical framework set forth in *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434 [60 L.Ed.2d 336, 99 S.Ct. 1813] and *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159 [77 L.Ed.2d 545, 103 S.Ct. 2933], we originally concluded that the tax method does not violate that clause. Several months after we issued our decision, the California Supreme Court issued its decision in *Barclays Bank Internat., Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708 [8 Cal.Rptr.2d 31, 829 P.2d 279] (*Barclays*). On June 18, 1992, the Supreme Court directed us to vacate our original decision in this case and refile it after modification in light of *Barclays*. The parties then filed supplemental briefs. As we explain, *Barclays* effects a substantial change in our foreign commerce clause analysis but no change in our original result. Consequently, we still reverse that part of the judgment regarding the foreign commerce clause issue and affirm that part of the judgment regarding the statutory and constitutional distortion issues.

BACKGROUND

The Methods of Allocating Income

When a corporation, either on its own or through subsidiaries, conducts business across state or national boundaries, the allocation of income to each relevant jurisdiction for purposes of taxation becomes an issue. To resolve this issue, two general methods of income allocation have been created: the arm's length/separate accounting method and the unitary business/formula apportionment method. Each of these two general methods can be applied in varying ways. (*Container Corp. v. Franchise Tax Bd., supra*, 463 U.S. at pp. 182, 191, 196 [77

Footnote continued from previous page.
outside California in order to reach the net income attributable to California activities. (Rev. & Tax. Code, §§ 25120-25139.)

In 1982, section 25101 was amended in a manner insignificant to our purposes. (States. 1982, ch. 466, § 104, p. 2055.)

L.Ed.2d at pp. 564, 570, 573]; Langbein (1986) 23 Tax Notes 625, 626; Note, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Colum. J. of Transnat'l L. 445, 451, hereafter 23 Columbia Journal.)

Under separate accounting, the related corporations of a multijurisdictional enterprise are viewed as distinct from one another; taxable income is determined separately for each individual corporation by the jurisdiction in which that corporation actually conducts business or has a permanent establishment. Any improper shifting of value between the related corporations to avoid taxes is corrected by requiring "arm's length" pricing in related corporate transactions. In other words, the related corporations must act as if they were unrelated entities dealing at arm's length in the marketplace.

In contrast, under the unitary business/formula apportionment method of allocating income at issue in this case — the worldwide unitary method — the related corporations of a multijurisdictional enterprise are treated as units of a single business — that is, as a "unitary group." (Cal. Code Regs., tit. 18, § 25137-6.)[2] If a corporation doing business in California is deemed to be part of a unitary group, the total income for that group worldwide, including corporations operating wholly outside the United States, is apportioned to California by a three-factor formula. Under the formula, the property, payroll, and sales figures for the group in California are arithmetically compared to the property, payroll, and sales figures for the group worldwide. (See Rev. & Tax. Code, §§ 25128-25136.) This comparison results in a proportion that is multiplied against the unitary group's worldwide income, producing an

[2] Generally, a corporation is included within the unitary group if its activities outside California are dependent upon or contribute to the business of a related corporation within California. (See *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472 [183 P.2d 16].)

apportioned amount of such income taxable by California.[3] Simply put, if 25 percent of the property, payroll, and sales of the unitary group is located in California, then 25 percent of the group's worldwide income is apportioned to California. Under this method, it is unnecessary to make "arm's length" corrections because intercorporate transactions are disregarded.

Aside from a few minor exceptions, the income allocation method used by the United States and all of the other nations of the world is the separate accounting, method, although, as noted, this method varies in practice. However, the United States has basically limited the application of its tax treaties to federal taxes. (*Container Corp. v. Franchise Tax Bd., supra,* 463 U.S. at p. 196 [77 L.Ed.2d at p. 573].)[4]

[3] The amount of the unitary group's income taxable by California is calculated as follows:

$$\frac{\frac{\text{In-State Property}}{\text{Total Property}} + \frac{\text{In-State Payroll}}{\text{Total Payroll}} + \frac{\text{In-State Sales}}{\text{Total Sales}}}{3} \times \begin{array}{l}\text{Unitary}\\ \text{Group's Total}\\ \text{Worldwide}\\ \text{Income}\end{array} = \text{Income Taxable by California.}$$

(Rev. & Tax. Code, §§ 25128-25137; 23 Columbia Journal at p. 445, fn. 2.)

[4] California in 1986 passed legislation, effective January 1, 1988, permitting taxpayers to make a "water's-edge election" notwithstanding Revenue and Taxation Code section 25101 (Rev. & Tax. Code, § 25110 et seq.).

This "water's-edge" method restricts tax allocation methods to the United States as the jurisdictional boundary, and offers an alternative to the worldwide unitary method for determining taxable income. (See Rev. & Tax. Code, §§ 25101, 25110.) Rather than accounting for the income and apportionment factors (property, payroll, and sales) of all the corporations of its worldwide unitary group, a corporate taxpayer making such an election accounts for the income and apportionment factors of the following entities affiliated with it, subject to some minor exceptions: corporations incorporated in the United States; any corporation, wherever incorporated, if the average of its apportionment factors within the United States is 20

Footnote continued...

The present controversy involves Colgate-Palmolive Company, Inc. (Colgate), a domestic-parent unitary corporate group with approximately 75 foreign subsidiaries operating in

---

Footnote continued from previous page.
percent or more; affiliated corporations which are eligible to be included in a federal consolidated tax return; domestic international sales corporations and foreign sales corporations engaged in sales in the United States; export trade corporations; any corporation not mentioned above but only to the extent of income derived from or attributable to sources within the United States; and any affiliated corporation which is a controlled foreign corporation as defined in the Internal Revenue Code. Any corporation not subjected to the worldwide unitary method under Revenue and Taxation Code section 25101 need not be included in this "water's-edge" accounting. (Rev. & Tax. Code, § 25110, subd. (a).)

In general, this election permits a taxpayer corporation to exclude the income and apportionment factors of foreign subsidiaries from the corporation's California tax base. An accounting restriction to the water's edge of the United States in the present context would mean that California could rely only on income derived from permanent establishments of Colgate in the United States, and not on income derived from wholly foreign interests, to calculate Colgate's franchise tax.

To qualify for the "water's-edge" election, the corporate taxpayer must (1) consent to the taking of depositions from key corporate personnel and to the production of documents to ensure the Franchise Tax Board has the information necessary to make genuine arm's length adjustments and unitary business investigations, and (2) agree that dividends received by any affiliated entity from corporations significantly related to the unitary business constitute business income of the taxpayer. (Rev. & Tax. Code, § 25110, subd. (b)(2).) Additionally, to qualify the corporate taxpayer must enter into a five-year contract with the Franchise Tax Board, pay an annual fee, and subject itself to various conditions. (Rev. & Tax. Code, §§ 25111-25115.)

A domestic-parent multinational corporation that does not make this election is subjected essentially to the 1970-1973 taxation method at issue here. (See fn. 1, *ante*.) We emphasize, however, that the principal issue in this case is the foreign commerce clause constitutionality of California's worldwide unitary tax method as applied to domestic-parent unitary corporate groups with foreign subsidiaries (Rev. & Tax. Code, §§ 25101 et seq.). Because California's "water's-edge election" is not involved in this case, we do not express any views regarding it. (Rev. & Tax. Code, § 25110 et seq.)

about 54 foreign counties [sic].[5] Colgate was directed to pay additional taxes for the years 1970 through 1973 after California applied the worldwide unitary tax method to the group. Under protest, Colgate paid the additional takes and this suit ensued.

The Issues on Appeal

At trial, Colgate challenged the federal constitutionality of these additional taxes on foreign commerce clause grounds. The thrust of Colgate's argument below was that the federal executive branch acted decisively after the *Container* decision to communicate its longstanding position that California's worldwide unitary tax method impermissibly interferes with American foreign policy; according to Colgate, this decisive action eliminated the factual ambiguity that resulted in the *Container* decision. The trial court agreed with this argument and determined that California's worldwide unitary tax method was unconstitutional on this ground. The Franchise Tax Board (the Board) appeals that decision here.

Colgate also argued at trial that California's three-factor unitary formula unlawfully "distorted" the amount of Colgate's income apportioned to California. The trial court found against Colgate on this issue, which Colgate again raises in its respondent's brief.[6]

Finally, two peripheral issues are raised by the Board in this appeal. First, the Board claims the trial court abused its discretion in denying the Board's motion for discovery sanctions. Secondly, the Board asserts the court below erroneously awarded certain costs to Colgate.

---

[5] Reversing its position below, Colgate on appeal does not dispute that it is a domestic-parent unitary corporate group.

[6] The Board moved to strike this argument on appeal, contending it was improperly raised in these proceedings. We denied the Board's motion.

The Foreign Commerce Clause

Article I, section 8, clause 3 of the United States Constitution empowers Congress "To regulate commerce with foreign nations, and among the several states, and with the Indian tribes." As the United States Supreme Court has long emphasized, this clause limits the power of the States even in the absence of Congressional legislation. (*Boston Stock Exchange v. State Tax Comm'n.* (1977) 429 U.S. 318, 328 [50 L.Ed.2d 514, 523, 97 S.Ct. 599]; *Freeman v. Hewit* (1946) 329 U.S. 249, 252 [91 L.Ed.2d 265, 271, 67 S.Ct. 274].) In this respect, the commerce clause indirectly allocates the relative powers of states and the federal government. (*Star-Kist Foods, Inc. v. County of Los Angeles* (1986) 42 Cal.3d 1, 9 [227 Cal.Rptr. 391, 719 P.2d 987].)

As noted in *Star-Kist*, "[d]etermining whether a state tax exceeds the bounds of permissible state action under the [commerce] clause is often a difficult task." (42 Cal.3d at p. 10.) In the context of the foreign commerce clause, there are three United States Supreme Court decisions that have delineated the test under which this determination is made: *Japan Line, Ltd. V. County of Los Angeles, supra*, 441 U.S. 434; *Container Corp. v. Franchise Tax Bd., supra*, 463 U.S. 159; and *Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1 [91 L.Ed.2d 1, 106 S.Ct. 2369].

Applying the foreign commerce clause test it created, the court in *Japan Line* held that instrumentalities of commerce — in that case, seagoing cargo containers — which are foreign-owned, -based, and -registered and which are used solely in international commerce may not be subjected to a state's apportioned ad valorem property tax. (441 U.S. at pp. 436, 444 [60 L.Ed.2d at pp. 340, 345].)

In creating the foreign commerce clause test, the *Japan Line* court noted that the issue of taxation between nations is more complicated than the issue of taxation between American states. This increased complexity results from a number of

factors, including the greater sensitivity to national as opposed to state sovereignty, the lack of an authoritative tribunal capable of resolving transnational disputes, and the fact that actions by individual states can work to the detriment of thSe whole country. (441 U.S. at pp. 447-451, 456 [60 L.Ed.2d at pp. 347-350. 352].) In light of these circumstances, said *Japan Line*, the foreign commerce power of Congress is greater than its interstate commerce power and the need for one national voice in regulating commercial relations with foreign nations is paramount. (*Id.* at pp. 448-449 [60 L.Ed.2d at pp. 347-348].)

From this comparison of the interstate and the foreign contexts, the foreign commerce clause test was born. That test was engendered by adding two inquiries onto the already existing four-part test for interstate commerce clause review. (*Japan Line, supra*, 441 U.S. at pp. 444-445, 451 [60 L.Ed.2d at pp. 345-346, 349-350].)

Under the four-part interstate test, a state tax will survive an interstate commerce clause challenge if the tax "'[i] is applied to an activity with a substantial nexus with the taxing State, [ii] is fairly apportioned, [iii] does not discriminate against interstate commerce, and [iv] is fairly related to the services provided by the State.'" (*Japan Line, supra*, 441 U.S. at pp. 444-445, 449, 454 [60 L.Ed.2d at pp. 345, 348, 352], quoting *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 279 [51 L.Ed.2d 326, 331, 97 S.Ct. 1076].)

The two additional inquiries prompted by the foreign context are: first, whether the tax creates a "substantial risk of international multiple taxation" (441 U.S. at p. 451 [60 L.Ed.2d at p. 349]); and, second, whether the tax "may impair federal uniformity in an area where federal uniformity is essential" (*Id.* at p. 448 [60 L.Ed.2d 347]), and prevents "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" (*Id.* at p. 451 [60 L.Ed.2d at p. 349], quoting *Michelin Tire Corp. v. Wages*

(1976) 423 U.S. 276, 285 [46 L.Ed.2d 495, 96 S.Ct. 535]; see also *Container, supra*, 463 U.S. at pp. 193-194 [77 L.Ed.2d at pp. 571-572]). If a state tax violates either of these precepts, it is unconstitutional under the foreign commerce clause. (441 U.S. at p. 451 [60 L.Ed.2d at p. 349].)

Because the foreign commerce clause is self-executing, the judiciary applies this test when Congress or the federal government has not acted or purported to act. (*Merrion v. Jicarilla Apache Tribe* (1982) 455 U.S. 130, 154-155 [71 L.Ed.2d 21, 40-41, 102 S.Ct. 894]; *Wardair, supra*, 477 U.S. at pp. 7-8, 18 [91 L.Ed.2d at pp. 9-10, 16].) In such "dormant" foreign commerce clause situations, the judiciary must determine whether a particular state action unduly threatens the purpose of the clause: to ensure a unified national voice in foreign commerce matters raising inherently national concerns and to ensure that individual states do not work to the detriment of the whole nation. (*Ibid*; see also *Japan Line, supra*, 441 U.S. at pp. 448-449 [60 L.Ed.2d at pp. 347-348].)

In *Japan Line*, the state tax at issue was found to violate both of the additional foreign commerce clause considerations. Multiple taxation resulted because the foreign country involved, Japan, taxed the cargo containers at full value. (441 U.S. at pp. 451-452 [60 L.Ed.2d at pp. 349-350].) The "one-voice" standard was violated because the United States and Japan had signed a convention reflecting a national policy to preclude such taxes. Furthermore, American-owned cargo containers were not taxed in Japan; this created an asymmetry in international taxation disadvantageous to Japan and, under such circumstances, the risk of Japanese retaliation against the whole nation was substantial. Finally, if other states enacted their own taxing schemes, taxation would vary port-by-port, making speaking with one voice impossible. (*Id.* at pp. 452-453 [60 L.Ed.2d at pp. 350-351].)

That brings us to the decision in *Container Corp. v. Franchise Tax Bd., supra*, 463 U.S. 159. *Container* involved the precise issue presented here: the constitutionality under the foreign commerce clause of California's worldwide unitary tax method as applied to a domestic-parent unitary corporate group (hereafter, domestic-parent group) with foreign subsidiaries. (*Id.* at pp. 163, 171 [77 L.Ed.2d at pp. 551-552, 557].) Applying essentially the dormant foreign commerce clause test set forth in *Japan Line*, the court in *Container* held the tax method constitutional. (*Id.* at pp. 185-197 [77 L.Ed.2d at pp. 566-574].)

In applying *Japan Line's* first additional foreign commerce clause consideration — the enhanced risk of international multiple taxation — *Container* noted that separate accounting did not inevitably end double taxation and California's worldwide unitary method did not inevitably lead to it. Given this state of affairs, said *Container*, it would be perverse constitutionally to require one method of taxation over another when both could result in a double tax. (463 U.S. at pp. 189-193 [77 L.Ed.2d at pp. 568-571].)

Container refined *Japan Line's* second additional foreign commerce clause consideration — the "one voice" standard — by stating: "In conducting this inquiry, ... we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, ... that treatment of foreign income at the federal level mandates identical treatment by the States.' [Citations.] Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of pre-emption analysis." (463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-752], italics in original.)

According to *Container*, the most obvious foreign policy implication of a state tax is the threat it might pose of offending foreign trading partners, leading them to retaliate against the whole nation. The court in *Container* noted that the judiciary has little competence in making this determination and emphasized that the nuances of foreign policy "are much more the province of the Executive Branch and Congress than of this Court." (463 U.S. at pp. 194, 196 [77 L.Ed.2d at pp. 571-573].) The best a court can do, said *Container*, is try to develop objective standards reflecting general observations about international trade and relations. (*Id.* at p. 194 [77 L.Ed.2d at pp. 571-572].)

Doing just that, the court in *Container* set forth three reasons that weighed strongly against the possibility of justifiable and significant foreign retaliation. First, California's worldwide unitary tax method as applied to domestic-parent groups did not create an *"automatic* 'asymmetry'" in international taxation disadvantageous to a foreign entity. (463 U.S. at pp. 194-195 [77 L.Ed.2d at pp. 571-572], italics in original.) Second, the tax method was applied to a domestic corporation rather than to a foreign entity. Finally, stated *Container*, even if foreign nations have a legitimate interest in reducing the tax burden of domestic corporations, that burden results more from tax rate than allocation method, and California can simply raise its tax rate to achieve the same foreign economic effect. (*Ibid.*)

Of course, noted *Container*, the threat of retaliation is not the only foreign policy implication a state tax may have. However, the court also noted there was no amicus curiae brief from the executive branch opposing the tax at issue and setting forth other foreign policy implications. Although not conclusive on the issue, the lack of such a brief did suggest American foreign policy was not seriously threatened by California's worldwide unitary method as applied to domestic-parent groups with foreign subsidiaries. (463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].)

The court in *Container* then turned to specific indications of congressional intent in discussing the "clear federal directive" principle and found little there.

No federal statute provided the preemptive force. Although the federal government was bound by numerous tax treaties to use some form of separate accounting in taxing the domestic income of multinational enterprises, that requirement was generally waived regarding the taxes imposed by each of the contracting nations on its own domestic corporations. If nothing else, said the *Container* court, this fact "confirms our view that such taxation is in reality of local rather than international concern." (*Container, supra*, 463 U.S. at p. 196 [77 L.Ed.2d at p. 573].) The tax treaties, moreover, did not generally cover state taxes; none of them prohibited states from using non-separate accounting methods of taxation. The United States Senate had on one occasion declined to give its two-thirds consent to a treaty provision that would have prohibited the states from using such methods. Finally, the court in *Container* noted that Congress had long debated but had not enacted legislation regulating state taxation of income. On this record, the court could not conclude that California's worldwide unitary method as applied to domestic-parent groups with foreign subsidiaries was preempted by federal law or fatally inconsistent with federal policy. (463 U.S. at pp. 196-197 [77 L.Ed.2d at pp. 573-574].)

The last of the three United States Supreme Court decisions critical to our dormant foreign commerce clause analysis is *Wardair Canada v. Florida Dept. of Revenue, supra*, 477 U.S. 1. The court in *Wardair*, however, did not have occasion to apply the dormant foreign commerce clause test created in *Japan Line* and refined in *Container*. This was because the *Wardair* court found it "abundantly clear" that the federal government had

affirmatively acted to permit the state tax at issue there. That tax was levied by Florida and applied to all airline aviation fuel sold within the state regardless of the airliner's destination or the amount of intrastate business the airliner did. (*Id.* at pp. 9, 12 [91 L.Ed.2d at pp. 10, 12].)

The foreign airliner and the United States as amicus curiae in *Wardair* argued there was a federal policy prohibiting Florida's unlimited tax. The policy was allegedly manifested by (1) the 1944 Chicago Convention on International Civil Aviation (1944 Convention), which the United States had signed; (2) a 1966 Resolution of the International Civil Aviation Organization (1966 Resolution), an organization to which the United States belonged; and (3) more than 70 bilateral aviation agreements, including the 1974 U.S.-Canadian Aviation Agreement (Agreement). (Wardair was a Canadian airline.) The *Wardair* court viewed this evidence in a completely different light — in fact, as manifesting a federal policy *permitting* Florida's tax. Accordingly, the dormant foreign commerce clause test of *Japan Line* and *Container* did not come into play — the federal government had made its position clear in permitting such state action. (477 U.S. at pp. 8-12 [91 L.Ed.2d at pp. 9-12].)

The court's analysis was as follows. The 1944 Convention prohibited only state taxation of aviation fuel "'on board an aircraft ... on arrival ... and retained on board on leaving.'" (*Wardair, supra,* 477 U.S. at p. 10 [91 L.Ed.2d at p. 11].) Consequently, according to the court, the international community had considered the issue of state taxation of aviation fuel and had decided to limit only certain state taxes while implicitly preserving the right of states to tax in nonprohibited ways. Although the 1966 Resolution indisputably sought to exempt airline fuel tax from all foreign national and subnational customs and duties, neither the executive branch nor Congress had acted in any way to make the Resolution legally binding. Furthermore, after the 1944 Convention came into

force, the United States entered into more than 70 bilateral aviation agreements; not one of these agreements prohibited states from imposing a Florida-like tax. The 1974 U.S.-Canadian Agreement was limited to "'national duties and charges.'" This limitation was particularly significant, reasoned the *Wardair* court, because the Agreement was entered into eight years after the 1966 Resolution — which addressed the concern of foreign subnational taxation — and because both parties to the Agreement were federalist nations. Finally, during the Agreement, other American states and some Canadian provinces had imposed Florida-like fuel taxes without challenge; this evidenced a course of conduct by the Agreement parties that such taxation was permissible. (*Id.* at pp. 10-12 [91 L.Ed.2d at pp. 11-12].)

According to the court in *Wardair*, "all of this makes abundantly clear" that the federal government has affirmatively acted to permit the states to impose these sales taxes on aviation fuel. (477 U.S. at p. 12 [91 L.Ed.2d at p. 12].) Consequently, the foreign commerce clause test of *Japan Line* and *Container* was inapplicable. (*Ibid.*)

With this background in mind, we turn to the foreign commerce clause issue presented here.

DISCUSSION

1. Does Wardair Apply Here To Preclude A Dormant Foreign Commerce Clause Analysis?

The first issue we must consider is whether the Board is correct that this case is akin to *Wardair* and that there is an affirmative federal policy permitting California to apply the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries. If the Board is correct, such affirmative action by the federal government will end our constitutional analysis because there will be no need to apply the dormant foreign commerce clause framework of *Japan Line*

and *Container*. As we explain, the Board is correct in light of the interpretation of *Wardair* set forth in *Barclays*.

The Board finds such an affirmative federal policy in the following five matters: (1) The United States income tax treaties with foreign countries bind the federal government to use some form of separate accounting but do not similarly bind the states; (2) The executive branch has adopted a Model Income Tax Treaty that does not apply to state taxation and has reserved its position on the Organization of Economic Cooperation and Development (OECD) Model Convention's application to subnational taxes; (3) The United States Friendship, Commerce, and Navigation (FCN) treaties with foreign countries do not contain any state taxation restrictions; (4) Congress has not enacted any legislation prohibiting or restricting state use of the worldwide unitary method; and (5) The United States Senate refused to give its two-thirds consent to article 9(4) in the United States-United Kingdom Tax Treaty, which would have prohibited states from applying the worldwide unitary method to U.K.-parent unitary corporate groups.

These same factors were presented to the court in *Barclays*. The court concluded they were sufficient to invoke the *Wardair* principle, thereby obviating the need to apply a dormant foreign commerce clause analysis.

As the *Barclays* court saw it, *Wardair* "reflects a diminution in the reach of dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, governmental silence may constitute a ratification of state taxation of foreign commerce, rendering a dormant analysis inapposite." (2 Cal.4th at p. 714.) As *Barclays* explains, "[i]n some cases where Congress affirmatively declines to adopt certain measures, the resulting governmental 'silence' is not the sort that triggers use of a dormant foreign commerce clause analysis." (*Id.* at p. 728.)

In concluding that the factors cited by the Board here were sufficient under *Wardair* to preclude a dormant foreign commerce clause analysis, the *Barclays* court noted that the "Senate's action with respect to article 9(4) is only the most explicit example of a persistent congressional refusal to enact curbs on the states' use of worldwide formula apportionment reaching back well before 1977, the tax year at issue in this case"; that "Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind"; and that "an extensive pattern of executive branch-negotiated diplomatic texts parallels, in our view, Congress's own unwillingness to disallow legislatively the states' application of formula apportionment methods to foreign-controlled multinational taxpayers, and bespeaks a coordinate 'acquiescence.'" (*Id.* at pp. 733, 736, 738-739, italics in original.)

The *Barclays* court then rendered the following conclusion: "It is clear that federal limitations on the states' use of worldwide formula apportionment is a controversial political and economic issue of which Congress has long been aware. In light of that history, we cannot turn away from the substantial evidence of Congress's repeated refusal to intervene in the regulation of state division of income methods for tax purposes, even one that provokes continuing international complaint. Under the compulsions of established constitutional doctrine, the courts sometimes are required to divine what foreign commerce policy Congress would pursue in the absence of any indication that it has thought about the subject; it is a quite different matter, however, for a court to ignore a pattern of congressional action that evidences both an awareness of an issue and a refusal to adopt the remedy urged upon it by executive officials and resisted by its state constituencies. The latter, we believe, viewed in context alongside additional treaty materials, is a governmental silence that is eloquent. ... [¶] We adhere to the central meaning of the high court's opinion in *Wardair* in holding that Congress's refusal to legislate

restrictions on state use of worldwide formula apportionment is not the sort of governmental silence that triggers a dormant foreign commerce clause analysis." (*Id.* at pp. 741-742.)

Of course, *Barclays* involved the question of whether California's worldwide unitary method of taxation as applied to *foreign*-parent groups was unconstitutional under the foreign commerce clause. Here we deal with the same question as applied to *domestic*-parent groups. Nevertheless, for purposes of whether *Wardair* applies in light of the factors cited by the Board, there is no distinction between this case and *Barclays*. For that reason, we are obligated to adopt the analysis in *Barclays* regarding *Wardair's* applicability. (*Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455-456 [20 Cal.Rptr. 321, 369 P.2d 937].)

Accordingly, the dormant foreign commerce clause analysis set forth in *Japan Line* and *Container* does not apply here. Congress has acted. "When Congress has struck the balance it deems appropriate, the courts are no longer needed to prevent States from burdening commerce ... Courts are final arbiters under the Commerce Clause only when Congress has not acted." (*Merrion v. Jicarilla Apache Tribe, supra,* 455 U.S. at pp. 154-155 [71 L.Ed.2d at p. 40]; see *Barclays, supra,* 2 Cal.4th at pp. 722, 725, fn. 9.) California's worldwide unitary method of taxation, as applied to domestic-parent groups with foreign subsidiaries, does not violate the foreign commerce clause of the United States Constitution.

2. Did California Unlawfully "Distort" the Amount of Colgate's Income Apportioned to California?

Although Colgate did not file a cross-appeal, it argues the trial court erroneously determined that California's application of the worldwide unitary tax method to Colgate did not unlawfully "distort" the amount of Colgate's income apportioned to California. We denied the Board's motion to strike

this argument from Colgate's respondent's brief. Accordingly, we consider the issue.

Colgate's argument is premised on what *Container* described as the "external consistency" requirement of fairness in an apportionment formula. Under that requirement, the application of a tax apportionment formula, such as California's worldwide unitary tax method, must be fair to pass constitutional scrutiny under both the due process and the commerce clauses; stated another way, the formula must actually reflect a reasonable sense of how income is generated. (*Container, supra,* 463 U.S. at pp. 169-170 [77 L.Ed.2d at pp. 555-556]; *Trinova Corp. v. Michigan Dept. of Treasury* (1991) 498 U.S. ___ [112 L.Ed.2d 884, 111 S.Ct. 818].) Under this constitutional edict, an apportionment formula will be invalidated if the taxpayer can prove by clear and cogent evidence that the income attributed to the state is "'out of all appropriate proportion to the business transacted by the [taxpayer] in that State'" or has "'led to a grossly distorted result.'" (*Container, supra,* 463 U.S. at pp. 170, 181 [77 L.Ed.2d at pp. 556, 563]; *Trinova, supra,* 498 U.S. at p. ___ [112 L.Ed.2d at pp. 908-909].)

In addition to the constitutional "external consistency" requirement, there is a statute in California on the subject. Revenue and Taxation Code section 25137 provides: "If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable: [¶] (a) Separate accounting; [¶] (b) The exclusion of any one or more of the factors; [¶] (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or [¶] (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

Colgate argues that California's worldwide unitary tax method apportioned 70 percent more income to California in comparison to separate accounting and that such apportionment contravenes both the constitutional and the statutory distortion principles. We disagree.

As noted by one commentator in reviewing *Container's* discussion of the constitutional distortion principle of "external consistency," the taxpayer's burden of proof on this issue is "steep if not insurmountable." (23 Columbia Journal at p. 457.) This is an accurate comment. In *Container*, the court noted that the three-factor formula used by California has not only "met our approval" but has become "something of a benchmark against which other apportionment formulas are judged." (463 U.S. at p. 170 [77 L.Ed.2d at p. 556].)

Container also noted the distortion figures in that case were based essentially on separate accounting methods that failed to account for the flow of value between the parts of the unitary business. (*Id.* at pp. 181-184 [77 L.Ed.2d at pp. 563-565].) The same can be said here.

Colgate argues the distortion arises here because Colgate's foreign subsidiaries are substantially more profitable than its California operations. That is, the foreign subsidiaries' lower property, payroll, and sale figures for the same level of productivity result in a distorted apportionment to California under the three-factor formula. In *Container*, the taxpayer made the same argument. The court in *Container* rejected this argument, stating: "The problem with this argument is obvious: the profit figures relied on by [the taxpayer] are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." (463 U.S. at p. 181 [77 L.Ed.2d at p. 563].)

Apparently, there is only one United States Supreme Court decision that has invalidated a state tax apportionment formula applied to a corporate income tax or a franchise tax of a

manufacturing or mercantile company like Colgate. (23 Columbia Journal at pp. 450-451; see also *Container, supra*, 463 U.S. at pp. 182-184 [77 L.Ed.2d at pp. 564-565].) That decision is from 1931 and is entitled *Hans Rees' Sons Inc. v. North Carolina ex rel. Maxwell* (1931) 283 U.S. 123 [75 L.Ed.2d 879, 51 S.Ct. 385]. In that case, a one-factor unitary tax method was applied to a domestic company. Although the company's income in *Hans Rees* was derived from a variety of far-flung activities — including buying, selling and manufacturing — North Carolina's statutory formula allocated the entire wholesale profit to North Carolina, where the manufacturing occurred. This allocation resulted in 250 percent more income attributed to the state. (283 U.S. at pp. 126-128 [75 L.Ed.2d at pp. 889-898]; see 23 Columbia Journal at p. 450; *Container, supra*, 463 U.S. at pp. 183-184 [77 L.Ed.2d at pp. 564-565].)

Colgate's 70 percent figure — which does not account for the flow of value between the parts of Colgate's unitary business — is not comparable to the 250 percent tally in *Hans Rees*. Colgate has not met the steep burden imposed by the constitutional distortion principle of "external consistency.[7]

Colgate realizes this and pins its hopes on Revenue and Taxation Code section 25137. Colgate faces an uphill battle here as well. Under section 25137 and California case law, the Franchise Tax Board is given discretion to select the factors to be used in a tax formula. (*McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 Cal.2d 506, 512 [72 Cal.Rptr. 465, 446 P.2d 313].) Where a taxpayer petitions for an alternative formula under section 25137, the taxpayer bears the burden of establishing by clear and convincing evidence that the formula used by the Franchise Tax Board reaches an unreasonable result in

---

[7] In a recent decision, the United States Supreme Court relied on *Container's* flow of value concept to uphold the application of the three-factor formula involved here to a value added tax on a unitary business. (*Trinova, supra*, 498 U.S. ___ [112 L.Ed.2d 884].)

his or her case. (*Ibid.*; Rev. & Tax. Code, § 25137; *Communications Satellite Corp. v. Franchise Tax Bd.* (1984) 156 Cal.App.3d 726, 746-749 [203 Cal.Rptr. 779]; see e.g., *Firestone Tire & Rubber Co. v. County of Monterey* (1990) 223 Cal.App.3d 382, 387-388 [272 Cal.Rptr. 745].)

Colgate argues that the trial court used the constitutional "out of all proportion" test to dismiss Colgate's statutory assertion under section 25137. Additionally, Colgate argues that testimony from the Board's counsel for multi-state tax affairs establishes that the Board unlawfully fails to consider separate accounting as an alternative for unitary companies under section 25137. The first of these arguments is meritless, rendering a discussion of the second unnecessary.

As noted by the Board, the trial court did not apply the constitutional "out of all proportion" test to the statutory issue. In reviewing the Board's denial of Colgate's section 25137 petition, the trial court cited *Container*'s "flow of value" concept and upheld the Board's determination that Colgate had not demonstrated by clear and convincing evidence that California's apportionment formula unfairly represented the extent of Colgate's business activity in California. (*Container, supra*, 463 U.S. at pp. 181-184 [77 L.Ed.2d at pp. 563-565].) This constituted a correct application of the statutory standard set forth in section 25137. (*McDonnell Douglas Corp. v. Franchise Tax Bd., supra*, 69 Cal.2d at p. 512; see *Amoco Production Company v. Armold* [sic] (1974) 213 Kan. 636 [518 P.2d 453, 463-465].)

Citing *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163, 176 [116 Cal.Rptr. 160], Colgate contends the right to recover taxes paid under protest is a fundamental vested right; therefore, the trial court was obligated to exercise its independent judgment on the section 25137 evidence. We disagree with Colgate for two reasons. First, the *Hunt-Wesson* court did not hold that the right to recover taxes paid under

protest is a fundamental vested right. That court said the argument could be made. (41 Cal.App.3d at p. 176.) Second, and more importantly, the precise issue involved here concerns the application of a particular tax method that is within the discretion of the Franchise Tax Board under statutory directive. (*McDonnell Douglas Corp. v. Franchise Tax Bd., supra*, 69 Cal.2d at p. 512; Rev. & Tax. Code, §§ 25120-25139; Cal. Code Regs., tit. 18, § 25137-6; see *Amoco Production Company v. Arnold, supra*, 518 P.2d at pp. 463-465; see, e.g., *Firestone Tire & Rubber Co. v. County of Monterey, supra*, 223 Cal.App.3d at pp. 387-388.) Colgate can hardly ascribe an individually "vested" status to this process. (See *Hunt-Wesson, supra* 41 Cal.App.3d at p. 174.) As noted, *McDonnell Douglas* is the relevant decision on this limited issue. (69 Cal.2d at p. 512.)

Our resolution of the statutory distortion issue renders irrelevant Colgate's argument that the Board unlawfully fails to consider separate accounting as an alternative for unitary companies under section 25137. Colgate has not shown that California's apportionment formula unfairly represented the extent of Colgate's business activity in California. The alternatives set forth in section 25137 are invoked only if the taxpayer makes that showing. Consequently, we do not address this argument.

3. The Sanctions and Costs Issues

The Board claims the trial court abused its discretion in denying the Board's motion for sanctions against Colgate. In that motion, the Board argued that Colgate unduly delayed in producing certain documents evidencing the unitary nature of Colgate's operations.

This matter arose when Colgate, during the first two days of trial, belatedly produced to the Board's counsel five boxes of documents pursuant to the Board's requests for production of documents and a court order based on those requests. Included in this belated production were documents relevant

to the operation of Colgate's Danish subsidiary and therefore relevant to the issue of whether Colgate's subsidiaries operated in a unitary fashion with the domestic parent corporation. This production occurred in mid-July 1988. It was not until mid-February 1989, however, that the Board moved for sanctions on this matter; this was after the trial was over and after the Board had won on the unitary issue. On these facts, the trial court declined to award sanctions because the motion was untimely and failed to evidence prejudice against the Board.

The trial court has broad discretion in imposing discovery sanctions, subject to reversal only for arbitrary, capricious or whimsical action. (See *Sauer v. Superior Court* (1987) 195 Cal.App.3d 213, 228 [240 Cal.Rptr. 489]; *Kahn v. Kahn* (1977) 68 Cal.App.3d 372, 380-381 [137 Cal.Rptr. 332] [although these cases were not decided under the current discovery statutes, the general principle of review they enunciate remains valid. (See former Code Civ. Proc., § 2034.)].) Code of Civil Procedure section 2023, subdivision (b)(1), upon which the Board relies, does not alter this well-settled principle and the Board concedes as much. That section and subdivision provides in pertinent part that "[i]f a monetary sanction is authorized by any provision of this article, the court shall impose that sanction unless it finds that the one subject to the sanction acted with substantial justification or that other circumstances make the imposition of the sanction unjust."

The Board argues that the trial court's finding of no prejudice conveys the message that it is acceptable to abuse discovery and conceal evidence, so long as the party seeking discovery cannot prove how those actions prejudiced its case. Of course, prejudice is difficult to prove in the face of victory. The Board's real concern is that such discovery abuse will go unpunished. The Board can rest assured that the trial court possesses an array of weapons to counter parties abusing the discovery process. These weapons include a "Monetary sanction," an "Issue sanction," an "Evidence sanction," a

"Terminating Sanction," and a "Contempt Sanction." (Code Civ. Proc., § 2023, subd. (b)(1)(2)(3)(4)(5).) The problem for the Board here is that a timely motion for sanctions is required to make these sanctions effective. The Board made its motion after the trial was over and after it had won on the issue for which it sought sanctions. And the Board cannot claim it did not know about the discovery abuse until it made its motion in February 1989. The Board admits it uncovered the abuse in July 1988 during the first days of trial.

The Board argues it was prejudiced because it could have moved for summary judgment on the unitary issue had the documents been timely produced, and the trial could have been shortened if not eliminated. We doubt seriously that operational documents concerning one of Colgate's 75 foreign subsidiaries were the only evidence standing in the way of a summary judgment motion on the unitary issue. In any event, the nature of the unitary issue is essentially factual and particular to the corporate enterprise being examined. For that reason, the issue would not usually be amenable to summary adjudication resolution.[8] We also doubt that Colgate's timely production could have eliminated or significantly shortened the trial. The testimony part of the trial also encompassed the distortion issues, and the heart of the lawsuit concerned the foreign commerce clause issue.

The trial court did not abuse its discretion in denying the Board's motion for discovery sanctions.

Our partial reversal of the judgment resolves the issue of costs awarded below to Colgate. Under our decision, Colgate is no longer the prevailing party and is therefore not entitled to costs.

---

[8] We note that, with certain exceptions, Code of Civil Procedure section 437c was amended in 1990 to eliminate motions for summary adjudication of issue(s).

DISPOSITION

The portion of the judgment regarding the foreign commerce clause issue is reversed. The portion of the judgment regarding the constitutional and statutory distortion issues and on the matter of sanctions is affirmed. The Board is awarded its costs on appeal.

Puglia, P.J., and Sparks, J., concurred.

APPENDIX C

COLGATE-PALMOLIVE COMPANY,
Respondent,

v.

FRANCHISE TAX BOARD,
Appellant.

No. S023147.

Supreme Court of the State of California,
in Bank.

June 18, 1992.

Prior report: Cal.App., 284 Cal.Rptr. 780.

The above-entitled cause is transferred to the Court of Appeal, Third Appellate District, with directions to vacate its decision and to refile the opinion after modification in light of *Barclays Bank International v. Franchise Tax Board* (1992) 2 Cal.4th 708, 8 Cal.Rptr.2d 31, 829 P.2d 279.

The Reporter of Decisions is directed to publish the opinion in the above-entitled case, as modified, in the Official Reports. See subdivision (c) of rule 978, California Rules of Court.

LUCAS, C.J., and MOSK, PANELLI, KENNARD, ARABIAN, BAXTER and GEORGE, J.J., concur.

APPENDIX D

COLGATE-PALMOLIVE COMPANY,
Respondent,

v.

FRANCHISE TAX BOARD,
Appellant.

No. S023147.

Supreme Court of the State of California,
in Bank.

Nov. 27, 1991.

Prior report: Cal.App., 284 Cal.Rptr. 780.

Respondent's petition for review GRANTED.

MOSK, PANELLI, KENNARD, ARABIAN, BAXTER and GEORGE, J.J., concur.

APPENDIX E

COLGATE-PALMOLIVE COMPANY,
Plaintiff and Respondent,

v.

FRANCHISE TAX BOARD,
Defendant and Appellant

No. C007044.

Court of Appeal of the State of California,
Third Appellate District.

Aug. 20, 1991.

DAVIS, Associate Justice.

The principal issue in this appeal is whether California's worldwide unitary method of taxation (based on Rev. & Tax. Code, § 25101, 25120-25139), as applied to domestic-parent unitary corporate groups, is unconstitutional under the foreign commerce clause of the United States Constitution. (U.S. Const., art. I, § 8, cl. 3.)[1] Using the legal framework set forth in

---

[1] During the tax years at issue (1970-1973), Revenue and Taxation Code section 25101 provided in pertinent part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter);..."

California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA), is contained in Article 2. That Act provides for formula apportionment of the net income from business activities both within and

Footnote continued...

Container Corp. v. Franchise Tax Bd. (1983) 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545, we conclude the tax method does not violate that clause. We therefore reverse in part the trial court's judgment.

BACKGROUND

The Methods of Allocating Income

When a corporation, either on its own or through subsidiaries, conducts business across state or national boundaries, the allocation of income to each relevant jurisdiction becomes an issue. To resolve this issue, two methods of income allocation have been created: the arm's length/separate accounting method and the unitary business/formula apportionment method. In reality, these methods simply highlight a general distinction: there are many different ways of specifically applying either of them. (*Container Corp. v. Franchise Tax Bd.*, supra, 463 U.S. at pp. 182, 191, 196, 103 S.Ct. at pp. 2949, 2954, 2956; Langbein, 23 Tax Notes (1986) 625, 626; Note, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Columbia Journal of Transnational Law 445, 451, hereafter 23 Columbia Journal.)

Under separate accounting, the related corporations of a multijurisdictional enterprise are viewed as distinct from one another; taxable income is determined separately for each individual corporation by the jurisdiction in which that corporation actually conducts business or has a permanent establishment. Any improper shifting of value between the related corporations to avoid taxes is corrected by requiring "arm's

---

Footnote continued from previous page.
outside California in order to reach the net income attributable to California activities. (Rev. & Tax.Code, §§ 25120-25139.)

In 1982, section 25101 was amended in a manner insignificant to our purposes. (Stats. 1982, ch. 466, § 104, p. 2055.)

length" pricing in related corporate transactions. In other words, the related corporations must act as if they were unrelated entities dealing at arm's length in the marketplace.

In contrast, under the unitary business/formula apportionment method of allocating income at issue in this case — the worldwide unitary method — the related corporations of a multijurisdictional enterprise are treated as units of a single business — that is, as a "unitary group." (Cal.Code Regs., tit. 18, § 25137-6.)[2] If a corporation doing business in California is deemed to be part of a unitary group, the total income for that group worldwide, including corporations operating wholly outside the United States, is apportioned to California by a three-factor formula. Under the formula, the property, payroll, and sales figures for the group in California are arithmetically compared to the property, payroll, and sales figures for the group worldwide. (See Rev. & Tax.Code, § 25128-25136.) This comparison results in a proportion that is multiplied against the unitary group's worldwide income, producing an apportioned amount of such income taxable by California.[3] Simply put, if 25 percent of the property, payroll, and sales of the unitary group is located in California, then 25 percent of the group's worldwide income is apportioned to California. Under this method, it is unnecessary to make "arm's length"

---

[2] Generally, a corporation is included within the unitary group if its activities outside California are dependent upon or contribute to the business of a related corporation within California. (See *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472, 183 P.2d 16.)

[3] The amount of the unitary group's income taxable by California is calculated as follows:

$$\frac{\frac{\text{In-State Property}}{\text{Total Property}} + \frac{\text{In-State Payroll}}{\text{Total Payroll}} + \frac{\text{In-State Sales}}{\text{Total Sales}}}{3} \times \begin{matrix}\text{Unitary}\\ \text{Group's Total}\\ \text{Worldwide}\\ \text{Income}\end{matrix} = \text{Income Taxable by California}$$

(Rev. & Tax. Code, §§ 25128-25137; 23 Columbia Journal at p. 445, fn. 2.)

corrections because intercorporate transactions are disregarded.

Aside from a few minor exceptions, the income allocation method used by the United States and all of the other nations of the world is the separate accounting method, although, as noted, this method varies in practice. However, the United States has basically limited the application of its tax treaties to federal taxes. (*Container Corp. v. Franchise Tax Bd.*, supra, 463 U.S. at p. 196, 103 S.Ct. at p. 2956.)[4]

---

[4] California in 1986 passed legislation, effective January 1, 1988, permitting taxpayers to make a "water's-edge election" notwithstanding Revenue and Taxation Code section 25101 (Rev. & Tax.Code, § 25110 et seq.).

This "water's-edge" method restricts tax allocation methods to the United States as the jurisdictional boundary, and offers an alternative to the worldwide unitary method for determining taxable income. (See Rev. & Tax.Code, §§ 25101, 25110.) Rather than accounting for the income and apportionment factors (property, payroll, and sales) of all the corporations of its worldwide unitary group, a corporate taxpayer making such an election accounts for the income and apportionment factors of the following entities affiliated with it, subject to some minor exceptions: corporations incorporated in the United States; any corporation, wherever incorporated, if the average of its apportionment factors within the United States is 20 percent or more; affiliated corporations which are eligible to be included in a federal consolidated tax return; domestic international sales corporations and foreign sales corporations engaged in sales in the United States; export trade corporations; any corporation not mentioned above but only to the extent of income derived from or attributable to sources within the United States; and any affiliated corporation which is a controlled foreign corporation as defined in the Internal Revenue Code. Any corporation not subjected to the worldwide unitary method under Revenue and Taxation Code section 25101 need not be included in this "water's-edge" accounting. (Rev. & Tax.Code, § 25110, subd. (a).)

In general, this election permits a taxpayer corporation to exclude the income and apportionment factors of foreign subsidiaries from the corporation's California tax base. An accounting restriction to the water's edge of the United States in the present context would mean that California could rely only on income derived from permanent establishments of Colgate in the United States, and not on income derived from wholly foreign interests, to calculate Colgate's franchise tax.

Footnote continued...

The present controversy involves Colgate-Palmolive Company, Inc. (Colgate), a domestic-parent unitary corporate group with approximately 75 foreign subsidiaries operating in about 54 foreign counties [sic].[5] Colgate was directed to pay additional taxes for the years 1970 through 1973 after California applied the worldwide unitary tax method to the group. Under protest, Colgate paid the additional taxes and this suit ensued.

The Issues on Appeal

At trial, Colgate challenged the federal constitutionality of these additional taxes on foreign commerce clause grounds. The thrust of Colgate's argument below was that the federal executive branch acted decisively after the *Container* decision

---

Footnote continued from previous page.

To qualify for the "water's-edge" election, the corporate taxpayer must (1) consent to the taking of depositions from key corporate personnel and to the production of documents to ensure the Franchise Tax Board has the information necessary to make genuine arm's length adjustments and unitary business investigations, and (2) agree that dividends received by any affiliated entity from corporations significantly related to the unitary business constitute business income of the taxpayer. (Rev. & Tax. Code, § 25110, subd. (b)(2).) Additionally, to qualify the corporate taxpayer must enter into a five-year contract with the Franchise Tax Board, pay an annual fee, and subject itself to various conditions. (Rev. & Tax.Code, §§ 25111-25115.)

A domestic-parent multinational corporation that does not make this election is subjected essentially to the 1970-1973 taxation method at issue here. (*See* fn. 1, *ante*.) We emphasize, however, that the principal issue in this case is the foreign commerce clause constitutionality of California's worldwide unitary tax method as applied to domestic-parent unitary corporate groups with foreign subsidiaries (Rev. & Tax.Code, § 25101 et seq.). Because California's "water's-edge election" is not involved in this case, we do not express any views regarding it. (Rev. & Tax.Code, § 25110 et seq.)

[5] Reversing its position below, Colgate on appeal does not dispute that it is a domestic-parent unitary corporate group.

to communicate its longstanding position that California's worldwide unitary tax method impermissibly interferes with American foreign policy; according to Colgate, this decisive action eliminated the factual ambiguity that resulted in the *Container* decision. The trial court agreed with this argument and determined that California's worldwide unitary tax method was unconstitutional on this ground. The Franchise Tax Board (the Board) appeals that decision here.

Colgate also argued at trial that California's three-factor unitary formula unlawfully "distorted" the amount of Colgate's income apportioned to California. The trial court found against Colgate on this issue, which Colgate again raises in its respondent's brief.[6]

Finally, two peripheral issues are raised by the Board in this appeal. First, the Board claims the trial court abused its discretion in denying the Board's motion for discovery sanctions. Secondly, the Board asserts the court below erroneously awarded certain costs to Colgate.

The Foreign Commerce Clause

Article I, section 8, clause 3 of the United States Constitution empowers Congress "To regulate commerce with foreign nations, and among the several states, and with the Indian tribes." As the United States Supreme Court has long emphasized, this clause limits the power of the States even in the absence of Congressional legislation. (*Boston Stock Exchange v. State Tax Comm'n.* (1977) 429 U.S. 318, 328, 97 S.Ct. 599, 606, 50 L.Ed.2d 514, 523; *Freeman v. Hewit* (1946) 329 U.S. 249, 252, 67 S.Ct. 274, 276, 91 L.Ed. 265, 271.) In this respect, the commerce clause indirectly allocates the relative powers of states and the federal government. (*Star-Kist Foods, Inc. v. County of*

[6] The Board moved to strike this argument on appeal, contending it was improperly raised in these proceedings. We denied the Board's motion.

Los Angeles (1986) 42 Cal.3d 1, 9, 227 Cal.Rptr. 391, 719 P.2d 987.)

As noted in *Star-Kist*, "[d]etermining whether a state tax exceeds the bounds of permissible state action under the [commerce] clause is often a difficult task." (42 Cal.3d at p. 10, 227 Cal.Rptr. 391, 719 P.2d 987.) In the context of the foreign commerce clause, there are three United States Supreme Court decisions that have delineated the test under which this determination is made: *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336; *Container Corp. v. Franchise Tax Bd.*, supra, 463 U.S. 159, 103 S.Ct. 2933; and *Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1, 106 S.Ct. 2369, 91 L.Ed.2d 1.

Applying the foreign commerce clause test it created, the court in *Japan Line* held that instrumentalities of commerce — in that case, seagoing cargo containers — which are foreign-owned, -based, and -registered and which are used solely in international commerce may not be subjected to a state's apportioned ad valorem property tax. (441 U.S. at pp. 436, 444, 99 S.Ct. at pp. 1815, 1819.)

In creating the foreign commerce clause test, the *Japan Line* court noted that the issue of taxation between nations is more complicated than the issue of taxation between American states. This increased complexity results from a number of factors, including the greater sensitivity to national as opposed to state sovereignty, the lack of an authoritative tribunal capable of resolving transnational disputes, and the fact that actions by individual states can work to the detriment of the whole country. (441 U.S. at pp. 447-451, 456, 99 S.Ct. at pp. 1820-1823, 1825.) In light of these circumstances, said *Japan Line*, the foreign commerce power of Congress is greater than its interstate commerce power and the need for one national voice in regulating commercial relations with foreign nations is paramount. (*Id.* at pp. 448-449, 99 S.Ct. at pp. 1821-1822.)

From this comparison of the interstate and the foreign contexts, the foreign commerce clause test was born. That test was engendered by adding two inquiries onto the already existing four-part test for interstate commerce clause review. (*Japan Line*, supra, 441 U.S. at pp. 444-445, 451, 99 S.Ct. at pp. 1819-1820, 1823.)

Under the four-part interstate test, a state tax will survive an interstate commerce clause challenge if the tax "'[i] is applied to an activity with a substantial nexus with the taxing State, [ii] is fairly apportioned, [iii] does not discriminate against interstate commerce, and [iv] is fairly related to the services provided by the State.'" (*Japan Line, supra*, 441 U.S. at pp. 444-445, 449, 454, 99 S.Ct. at pp. 1819-1820, 1822, 1824, quoting *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 279, 97 S.Ct. 1076, 51 L.Ed.2d 326.)

The two additional inquiries prompted by the foreign context are: first, whether the tax creates a "substantial risk of international multiple taxation" (441 U.S. at p. 451, 99 S.Ct. at p. 1823); and, second, whether the tax "may impair federal uniformity in an area where federal uniformity is essential" (*Id.* at p. 448, 99 S.Ct. at p. 1821), and prevents "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" (*Id.* at p. 451, 99 S.Ct. at p. 1823, quoting *Michelin Tire Corp. v. Wages* (1976) 423 U.S. 276, 285, 96 S.Ct. 535, 540, 46 L.Ed.2d 495; see also *Container, supra*, 463 U.S. at pp. 193-194, 103 S.Ct. at pp. 2954-2955.) If a state tax violates either of these precepts, it is unconstitutional under the foreign commerce clause. (*Id.* 441 U.S. at p. 451, 99 S.Ct. at p. 1823.)

Because the foreign commerce clause is self-executing, the judiciary applies this test when Congress or the federal government has not acted or purported to act. (*Merrion v. Jicarilla Apache Tribe* (1982) 455 U.S. 130, 154-155, 102 S.Ct. 894, 910-911, 71 L.Ed.2d 21; *Wardair, supra*, 477 U.S. at pp. 7-8, 18, 106 S.Ct.

at pp. 2372-2373, 2378.) In such "dormant" foreign commerce clause situations, the judiciary must determine whether a particular state action unduly threatens the purpose of the clause: to ensure a unified national voice in foreign commerce matters raising inherently national concerns and to ensure that individual states do not work to the detriment of the whole nation. (*Ibid.*; see also *Japan Line, supra*, 441 U.S. at pp. 448-449, 99 S.Ct. at pp. 1821-1822.)

In *Japan Line*, the state tax at issue was found to violate both of the additional foreign commerce clause considerations. Multiple taxation resulted because the foreign country involved, Japan, taxed the cargo containers at full value. (441 U.S. at pp. 451-452, 99 S.Ct. at pp. 1823-1824.) The "one-voice" standard was violated because the United States and Japan had signed a convention reflecting a national policy to preclude such taxes. Furthermore, American-owned cargo containers were not taxed in Japan; this created an asymmetry in international taxation disadvantageous to Japan and, under such circumstances, the risk of Japanese retaliation against the whole nation was substantial. Finally, if other states enacted their own taxing schemes, taxation would vary port-by-port, making speaking with one voice impossible. (*Id.* at pp. 452-453, 99 S.Ct. at pp. 1823-1824.)

That brings us to the decision in *Container Corp. v. Franchise Tax Bd.*, supra, 463 U.S. 159, 103 S.Ct. 2933. The importance of the *Container* decision to our analysis cannot be overstated. *Container* involved the precise issue presented here: the constitutionality under the foreign commerce clause of California's worldwide unitary tax method as applied to a domestic-parent unitary corporate group (hereafter, domestic-parent group) with foreign subsidiaries. (*Id.* at pp. 163, 171, 103 S.Ct. at pp. 2939, 2943.) Applying essentially the dormant foreign commerce clause test set forth in *Japan Line*, the court in *Container* held the tax method constitutional. (*Id.* at pp. 185-197, 103 S.Ct. at pp. 2950-2957.)

Initially, *Container* noted the similarities and differences between itself and *Japan Line*. Similar to *Japan Line*, in *Container* actual double taxation had occurred, such taxation resulted from a serious divergence between California and foreign taxing methods, and the foreign taxing methods accorded with the international practice of separate accounting. At this point, *Container* added: "... our own Federal Government, to the degree it has spoken, seems to prefer the taxing method adopted by the international community to the taxing method adopted by California." (463 U.S. at p. 187, 103 S.Ct. at p. 2952.) Unlike *Japan Line*, the tax in *Container* was on income rather than on property, double taxation did not inevitably result from California's worldwide unitary method, and the tax fell on a corporation domiciled and headquartered in the United States rather than on foreign owners. (*Id.* at pp. 187-188, 103 S.Ct. at pp. 2951-2952.) At this point, *Container* noted "[w]e have no need to address in this opinion the constitutionality of [the worldwide unitary method] with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (*Id.* at p. 189, fn. 26, 103 S.Ct. at p. 2952-2953, fn. 26.)

In applying *Japan Line*'s first additional foreign commerce clause consideration — the enhanced risk of international multiple taxation — *Container* noted that separate accounting did not inevitably end double taxation and California's worldwide unitary method did not inevitably lead to it. Given this state of affairs, said *Container*, it would be perverse constitutionally to require one method of taxation over another when both could result in a double tax. (463 U.S. at pp. 189-193, 103 S.Ct. at pp. 2952-2953.)

Container refined *Japan Line*'s second additional foreign commerce clause consideration — the "one voice" standard — by stating: "In conducting this inquiry, ... we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some

explicit directive from Congress, ... that treatment of foreign income at the federal level mandates identical treatment by the States.' [Citations.] Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of preemption analysis." (463 U.S. at p. 194, 103 S.Ct. at p. 2955, emphasis in original.)

According to *Container*, the most obvious foreign policy implication of a state tax is the threat it might pose of offending foreign trading partners, leading them to retaliate against the whole nation. The court in *Container* noted that the judiciary has little competence in making this determination and emphasized that the nuances of foreign policy "are much more the province of the Executive Branch and Congress than of this Court." (463 U.S. at pp. 194, 196, 103 S.Ct. at pp. 2955, 2956.) The best a court can do, said *Container*, is try to develop objective standards reflecting general observations about international trade and relations. (*Id.* at p. 194, 103 S.Ct. at p. 2955.)

Doing just that, the court in *Container* set forth three reasons that weighed strongly against the possibility of justifiable and significant foreign retaliation. First, California's worldwide unitary tax method as applied to domestic-parent groups did not create an *"automatic* 'asymmetry'" in international taxation disadvantageous to a foreign entity. (463 U.S. at pp. 194-195, 103 S.Ct. at pp. 2955-2956, emphasis in original.) Second, the tax method was applied to a domestic corporation rather than to a foreign entity. Here again, *Container* emphasized the domestic versus foreign construct, adding that a tax falling on a domestic corporation "might be less significant in the case of a domestic corporation that was owned by foreign interests." (*Id.* at p. 195, fn. 32, 103 S.Ct. at p. 2956.) Finally, stated *Container*, even if foreign nations have a legitimate interest in reducing the tax burden of domestic corporations,

that burden results more from tax rate than allocation method, and California can simply raise its tax rate to achieve the same foreign economic effect. (*Ibid.*)

Of course, noted *Container*, the threat of retaliation is not the only foreign policy implication a state tax may have. However, the court also noted there was no amicus curiae brief from the executive branch opposing the tax at issue and setting forth other foreign policy implications. Although not conclusive on the issue, the lack of such a brief did suggest American foreign policy was not seriously threatened by California's worldwide unitary method as applied to domestic-parent groups with foreign subsidiaries. (463 U.S. at pp. 195-196, 103 S.Ct. at pp. 2955-2956.) The court did note the solicitor general had submitted a brief opposing state use of the worldwide unitary method in a domestic corporation case argued the previous term and carried over to the present term. Nevertheless, said the court, there was no indication that the position set forth in the solicitor general's brief still represented the government's view or that the solicitor general's brief should apply to the *Container* case. (*Id.* at p. 195, fn. 33, 103 S.Ct. at p. 2956, fn. 33.)

The court in *Container* then turned to specific indications of congressional intent in discussing the "clear federal directive" principle and found little there.

No federal statute provided the preemptive force. Although the federal government was bound by numerous tax treaties to use some form of separate accounting in taxing the domestic income of multinational enterprises, that requirement was generally waived regarding the taxes imposed by each of the contracting nations on its own domestic corporations. If nothing else, said the *Container* court, this fact "confirms our view that such taxation is in reality of local rather than international concern." (*Container, supra,* 463 U.S. at p. 196, 103 S.Ct. at p. 2956.) The tax treaties, moreover, did

not generally cover state taxes; none of them prohibited states from using non-separate accounting methods of taxation. The United States Senate had on one occasion declined to give its two-thirds consent to a treaty provision that would have prohibited the states from using such methods. Finally, the court in *Container* noted that Congress had long debated but had not enacted legislation regulating state taxation of income. On this record, the court could not conclude that California's worldwide unitary method as applied to domestic-parent groups with foreign subsidiaries was preempted by federal law or fatally inconsistent with federal policy. (463 U.S. at pp. 196-197.)

The last of the three United States Supreme Court decisions critical to our dormant foreign commerce clause analysis is *Wardair Canada v. Florida Dept. of Revenue*, supra, 477 U.S. 1, 106 S.Ct. 2369. The court in *Wardair*, however, did not have occasion to apply the dormant foreign commerce clause test created in *Japan Line* and refined in *Container*. This was because the *Wardair* court found it "abundantly clear" that the federal government had affirmatively acted to permit the state tax at issue there. That tax was levied by Florida and applied to all airline aviation fuel sold within the state regardless of the airliner's destination or the amount of intrastate business the airliner did. (*Id.* at pp. 9, 12, 106 S.Ct. at pp. 2373, 2375.)

The foreign airliner and the United States as amicus curiae in *Wardair* argued there was a federal policy prohibiting Florida's unlimited tax. The policy was allegedly manifested by (1) the 1944 Chicago Convention on International Civil Aviation (1944 Convention), which the United States had signed; (2) a 1966 Resolution of the International Civil Aviation Organization (1966 Resolution), an organization to which the United States belonged; and (3) more than 70 bilateral aviation agreements, including the 1974 U.S.-Canadian Aviation Agreement (Agreement). (Wardair was a Canadian airline.) The *Wardair* court viewed this evidence in a completely different light — in fact, as manifesting a federal policy

permitting Florida's tax. Accordingly, the dormant foreign commerce clause test of *Japan Line* and *Container* did not come into play — the federal government had made its position clear in permitting such state action. (477 U.S. at pp. 8-12, 106 S.Ct. at pp. 2373-2375.)

The court's analysis was as follows. The 1944 Convention prohibited only state taxation of aviation fuel "'on board an aircraft ... on arrival ... and retained on board on leaving.'" (*Wardair, supra*, 477 U.S. at p. 10, 106 S.Ct. at p. 2374.) Consequently, according to the court, the international community had considered the issue of state taxation of aviation fuel and had decided to limit only certain state taxes while implicitly preserving the right of states to tax in nonprohibited ways. Although the 1966 Resolution indisputably sought to exempt airline fuel tax from all foreign national and subnational customs and duties, neither the executive branch nor Congress had acted in any way to make the Resolution legally binding. Furthermore, after the 1944 Convention came into force, the United States entered into more than 70 bilateral aviation agreements; not one of these agreements prohibited states from imposing a Florida-like tax. The 1974 U.S.-Canadian Agreement was limited to "'national duties and charges.'" This limitation was particularly significant, reasoned the *Wardair* court, because the Agreement was entered into eight years after the 1966 Resolution — which addressed the concern of foreign subnational taxation — and because both parties to the Agreement were federalist nations. Finally, during the Agreement, other American states and some Canadian provinces had imposed Florida-like fuel taxes without challenge; this evidenced a course of conduct by the Agreement parties that such taxation was permissible. (*Id.* at pp. 10-12, 106 S.Ct. at pp. 2374-2375.)

According to the court in *Wardair*, "all of this makes abundantly clear" that the federal government has affirmatively acted to permit the states to impose these sales taxes on aviation fuel. (477 U.S. at p. 12, 106 S.Ct. at p. 2375.) Consequently, the foreign commerce clause test of *Japan Line* and *Container* was inapplicable. (*Ibid.*)

With this background in mind, we turn to the foreign commerce clause issue presented here.

DISCUSSION

1. Does Wardair Apply Here To Preclude A Dormant Foreign Commerce Clause Analysis?

The first issue we must consider is whether the Board is correct that this case is akin to *Wardair* and that there is an affirmative federal policy permitting California to apply the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries. If the Board is correct, such affirmative action by the federal government will end our constitutional analysis because there will be no need to apply the dormant foreign commerce clause test of *Japan Line* and *Container*. As we explain, however, the Board is not correct.

The Board finds such an affirmative federal policy in the following five matters: (1) The United States income tax treaties with foreign countries bind the federal government to use some form of separate accounting but do not similarly bind the states; (2) The executive branch has adopted a Model Income Tax Treaty that does not apply to state taxation and has reserved its position on the Organization of Economic Cooperation and Development (OECD) Model Convention's application to subnational taxes; (3) The United States Friendship, Commerce, and Navigation (FCN) treaties with foreign countries do not contain any state taxation restrictions; (4) Congress has not enacted any legislation prohibiting or restricting state use of the worldwide unitary method; and (5) The United States Senate rejected article 9(4) in the United States-United Kingdom Tax Treaty, which would have prohib-

ited states from applying the worldwide unitary method to U.K.-parent unitary corporate groups.

The treaties and treaty actions set forth in (1) through (3) above do not support the Board's *Wardair* position. This is because those treaties and actions, aside from the U.S.-U.K. Tax Treaty which we discuss shortly, either do not consider state taxation at all or do so in only the most general way. Not one of the treaties or actions, with the exception noted, specifically addresses state use of the worldwide unitary method. The affirmative federal policy expressed in these treaties and actions is the general principle of preserving state sovereignty rather than the specific principle of permitting states to use the worldwide unitary method.

The Board argues that since the bilateral income tax treaties bind only the federal government, and not the states, to use some form of separate accounting, that constitutes, under *Wardair*, "an omission which must be understood as representing a policy choice ..." permitting state use of the worldwide unitary method. (477 U.S. at p. 11, 106 S.Ct. at p. 2374.) This argument fails for two reasons. First, as noted previously, these tax treaties either do not consider the issue of state taxation at all or do so in only the most general fashion. It cannot be argued seriously that *policy choices* regarding methods of state taxation are being made in this climate. Second, and more specifically, there are many different separate accounting methods and many different unitary accounting methods. (*Container, supra*, 463 U.S. at pp. 182, 191, 196, 103 S.Ct. at pp. 2949, 2954, 2956; Langbein, 23 Tax Notes, supra, at p. 626; 23 Columbia Journal at p. 451.) Accordingly, just because an income tax treaty commits the federal government to a particular form of separate accounting does not automatically mean the states can use the worldwide unitary method. Again, the limitation to the federal government, in this context, is a general limitation to preserve state sovereignty and not a specific affirmation of state use of the worldwide unitary method.

Nor can much affirmative action be discerned from the *absence* of congressional legislation prohibiting or restricting state use of the worldwide unitary method. Under the Board's argument, we are to presume that Congress has affirmatively stated its position through silence. We are unpersuaded. It is just as easy to say that the *absence* of congressional legislation allowing the states to use the worldwide unitary method affirmatively indicates that Congress does not want the states to use that method. Furthermore, how is a court to construe legislative silence? In this context, affirmative legislative silence is an oxymoronic concept which sheds no light on the issue.

That leaves the fifth factor — the United States Senate action on the U.S.-U.K. Tax Treaty.

This treaty was signed by the executive branch in 1975 and contained a provision — article 9(4) — that would have prohibited states from applying the worldwide unitary method to U.K.-parent groups. The United States Senate ratified the treaty only after article 9(4) was in effect deleted through a reservation by Senator Church.

The problem for the Board regarding this matter is that Senator Church's reservation was defeated in committee and on the senate floor, and the treaty with article 9(4) included was voted upon favorably by a margin of 49 to 32. True, the treaty fell 5 votes short of the two-thirds majority needed for ratification and was ratified only after the Church reservation was exhumed without a vote. But, three Senate majorities approving article 9(4) hardly argue for the proposition that Congress has affirmatively acted to permit the states to use the worldwide unitary method.

In its opening brief, the Board argues the Senate action on article 9(4) indicated a congressional policy permitting states to use the worldwide unitary method because the executive branch has never again negotiated an income tax treaty — ratified by the Senate — which either restricted or prohibited

state use of the worldwide unitary method. However, the answer to this argument is found on the very next page of the Board's brief, where the Board acknowledges that "[t]he Senate debate ... on article 9(4) shows the preferred method to deal with the issue of the states' use of the worldwide unitary method was on a comprehensive legislative basis." In other words, the Senate and the executive — the two entities responsible for making treaties — have acknowledged that the treaty process is not the preferred way to resolve this issue. (U.S. Const., art. II, 2, cl. 2.)

In marked contrast to the factors relied upon here by the Board stand the factors relied upon by the court in *Wardair*. In *Wardair*, the 1944 Convention specified which state taxes on aviation fuel could not be imposed, thereby strongly implying that other state taxes on aviation fuel could be imposed. Moreover, the 1966 Resolution specifically addressed the concern of subnational taxation. It was in the context of these two foundational documents that the American government and foreign governments negotiated many of their bilateral aviation agreements. In other words, the aviation agreements were being negotiated with an awareness of the type of tax involved in *Wardair* and the agreements did not prohibit such a tax. In fact, the relevant agreement in *Wardair* — the 1974 U.S.-Canadian Agreement — was limited to national taxes, was signed by two federalist nations long after the 1944 Convention and the 1966 Resolution, and was performed in a manner indicating the tax involved in *Wardair* was permitted. These factors in *Wardair* made it "abundantly clear" that the federal government had "affirmatively decided to permit the States to impose these sales taxes on aviation fuel." (477 U.S. at p. 12, 106 S.Ct. at p. 2375.) The same cannot be said for the factors cited here by the Board.

Our conclusion that *Wardair* is inapplicable is buttressed by the fact that the *Container* court had before it all of the significant factors upon which the Board relies and nevertheless

engaged in a dormant foreign commerce clause analysis. (463 U.S. at pp. 196-197, 103 S.Ct. at pp. 2956-2957.) Obviously, the *Container* court did not think the Board's factors made it "abundantly clear" that the federal government had affirmatively acted to permit the states to apply the worldwide unitary method to domestic-parent groups with foreign subsidiaries. Accordingly, we proceed to a foreign dormant commerce clause analysis and apply the corresponding test created in *Japan Line* and refined in *Container*.

2. The Applicable Test and Standard of Review

Under the dormant foreign commerce clause test created in *Japan Line*, a state taxation method is unconstitutional if it either creates a "substantial risk of international multiple taxation" or "may impair federal uniformity in an area where federal uniformity is essential" and prevents "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" (441 U.S. at pp. 448, 451, 99 S.Ct. at pp. 1821-1823.) In refining *Japan Line*'s "one voice" standard, *Container* stated: "... we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '(a)bsent some explicit directive from Congress, ... that treatment of foreign income at the federal level mandates identical treatment by the States.' [Citations.] Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive [the second of these considerations being essentially a species of preemption analysis]." (463 U.S. at p. 194, 103 S.Ct. at p. 2955, emphasis in original.)

As for the standard of review, Colgate asserts we must use a two-step procedure. First, we are to determine whether substantial evidence supports the trial court's factual finding that California's use of the worldwide unitary method interferes

with American foreign policy. Secondly, we are to apply the constitutional "one voice" standard to that supported factual finding. Colgate's position is not without constitutional analogy — it is similar to the constitutional appellate inquiry conducted in Fourth Amendment cases. (See *People v. Leyba* (1981) 29 Cal.3d 591, 596-597, 174 Cal.Rptr. 867, 629 P.2d 961.) Nevertheless, the Board correctly sets forth the simpler standard of review we use here.

The foreign commerce clause issue in this case was submitted solely on exhibits that were not materially disputed by either of the parties. The issue, therefore, reduces to the applicability of the foreign commerce clause to uncontradicted facts. This presents a question of law and we are not bound by the trial court's findings. (*Western Contracting Corp. v. State Board of Equalization* (1968) 265 Cal.App.2d 568, 575, 71 Cal.Rptr. 472; *C.R. Fedrick, Inc. v. State Bd. of Equalization* (1988) 204 Cal.App.3d 252, 258, 251 Cal.Rptr. 305.) Accordingly, we independently analyze the foreign commerce clause issue presented here. With these general guidelines in mind, we apply the relevant constitutional tests.

A. The Enhanced Risk of Multiple Taxation

On this issue, there is no distinction between this case and *Container*. Having nothing distinctive to say, we simply reiterate *Container*'s conclusion that California's application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries is not unconstitutional on this ground.

B. Whether California's Application Of The Worldwide Unitary Method To Domestic-Parent Groups With Foreign Subsidiaries May Impair Federal Uniformity In An Area Where Federal Uniformity Is Essential And Prevents The Federal Government From Speaking With One Voice In Regulating Commercial Relations With Foreign Governments

In the context of the case before us, the "foreign policy implications" and the "clear federal directive" strands of *Container*'s "one voice" refinement become somewhat muddled. Essentially, the position of Colgate — and of the trial court below — is that after *Container* the federal executive branch acted to communicate clearly its longstanding policy that states are not to apply the worldwide unitary tax method to any multinational corporation — be it domestic-parent or foreign-parent — because such application interferes with the federal government's conduct of foreign policy and foreign affairs. For this position, Colgate and the trial court relied on (1) a 1985 statement issued by President Ronald Reagan, (2) a 1986 letter from Secretary of State George Shultz to California Governor George Deukmejian, (3) a 1986 letter from Treasury Secretary James Baker to Senator Bob Packwood, chairman of the Senate Finance Committee (an identical letter was sent by Secretary Baker to Representative Dan Rostenkowski, chairman of the House Ways and Means Committee), (4) an amicus trial brief from the United States filed in another case this court reviewed (*Barclays Bank v. Franchise Tax Bd.* 225 Cal.App.3d 1342, 275 Cal.Rptr. 626 (1990) (ptn. for review granted 2/28/91), and (5) statements by two attorneys from the United States Department of Justice that the views expressed in that amicus brief remained unchanged at the time of trial in this case.

Before we analyze the substance of this issue, we must address the Board's contention that the statements and letters noted above do not constitute evidence we can consider. We

reject the Board's contention for three reasons. First, statements and letters from executive branch officials have been recognized as evidence by both the United States Supreme Court and the California courts. (*Zschernig v. Miller* (1968) 389 U.S. 429, 437, fn. 7, 88 S.Ct. 664, 669, fn. 7, 19 L.Ed.2d 683; *Spindulys v. Los Angeles Olympic Organizing Com.* (1985) 175 Cal.App.3d 206, 210, fn. 3, 220 Cal.Rptr. 565.) Second, in *Container*, diplomatic letters and notes from foreign governments were admitted into the record. (463 U.S. at p. 203, fn. 4, 103 S.Ct. at p. 2960, fn. 4.) Finally, the Board concedes the authenticity of these statements and letters. Under these circumstances, we conclude the statements and letters constitute evidence we can consider.

To analyze this evidence adequately, however, some background is required. The distinction between a domestic-parent and a foreign-parent group was deemed significant by the *Container* court. That court explicitly reserved the issue of "the constitutionality of [the worldwide unitary method] with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (463 U.S. at p. 189, fn. 26, 103 S.Ct. at p. 2953. fn. 26.) That court also carefully noted the tax there was imposed on a domestic-parent group, "not on a foreign entity as was the case in *Japan Line*;" and that "[a]lthough California 'counts' income arguably attributable to foreign corporations [i.e., foreign subsidiaries] in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation." (*Id.* at p. 195, 103 S.Ct. at p. 2956.) Finally, *Container* recognized "that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests." (*Id.* at p. 195, fn. 32, 103 S.Ct. at p. 2956, fn. 32.)

In response to complaints about the *Container* decision raised by the domestic and the foreign business communities

and by foreign governments, President Reagan in 1983 asked then Treasury Secretary Donald Regan to establish and chair a Worldwide Unitary Taxation Working Group (Working Group). The Working Group was comprised of representatives of the federal government, the state governments, and the business community, and was to provide recommendations on the worldwide unitary issue. No foreign government representative was appointed.

At its final meeting in May 1984, the Working Group agreed on three principles to guide state taxation of multinational corporations: (1) "Water's edge" unitary combination for both domestic-parent and foreign-parent groups (i.e., essentially an allocation method with the United States as the relevant jurisdiction); (2) Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability; and (3) Competitive balance for domestic-parent groups, foreign-parent groups, and purely domestic businesses. In transmitting the Working Group's report to the President, Secretary Regan indicated he would recommend restrictive federal legislation if the states had not made substantial voluntary progress on the worldwide unitary issue by the end of July 1985.

It was against this backdrop that President Reagan issued the (November) 1985 statement involved here. In that statement, the President said in pertinent part: "Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the concept of legislation that would: [¶] 1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ('the water's edge requirement'); and [¶] 2. Address the question of equitable taxation of foreign source dividends. [¶] We hoped that by this time these prin-

ciples would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting [sic] Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. ... [¶] Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach."

Our task is to analyze this statement as well as the other statements, letters, and briefs noted above from executive branch officials to determine if they either constitute an authoritative expression of the federal government that state application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries implicates foreign policy issues which must be left to the federal government or constitute a clear federal directive violated by California here. (*Container, supra*, 463 U.S. at p. 194, 103 S.Ct. at p. 2955.)[7] For the reasons set forth below, we conclude that California's application of the worldwide unitary tax method to Colgate does not offend the foreign commerce clause.

President Reagan issued his 1985 statement against the backdrop of the *Container* decision and the recommendations of the Working Group. In line with those recommendations, President Reagan stated the federal government's support for legislation that would effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States (the "water's edge" requirement). The

[7] We assume without deciding that the "clear federal directive" precept set forth in *Container* applies to directive from the federal executive branch. (*Container, supra*, 463 U.S. at pp. 194-197, 103 S.Ct. at pp. 2955-2957; see also Tribe, American Constitutional Law (2d ed. 1988) Federal Executive Power, §§ 4-4, 4-6, pp. 219-225, 230.)

President's statement did not distinguish between domestic-parent and foreign-parent multinationals. From this, it reasonably can be inferred that the executive branch — at least when President Reagan was at the helm — did not want states applying the worldwide unitary method to domestic-parent groups.

Nevertheless, when we examine the other parts of President Reagan's statement in the context of the foreign commerce clause issue presented here, this reasonable inference starts to erode.

Pursuant to the President's statement, the Attorney General was instructed "to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach." In the context of the case before us, this instruction is most troubling. This is because the executive branch has neither filed an amicus brief here nor indicated in any way its position on the issue presented in this case: California's application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries.

We can conceive of no more appropriate a case than this one for the executive branch to make its post-*Container* position clear. The factual context of this case is identical to *Container*. *Container* noted the absence of an executive branch amicus brief and noted that foreign policy nuances are much more the province of the executive branch and Congress than of the judiciary. (463 U.S. at pp. 195-196, 103 S.Ct. at pp. 2955-2956.) As one commentator on the *Container* decision has noted, "[g]iven the unusual attention paid to his absence, the Solicitor General's position in future appeals is certain to be a focus of attention." (WhiteNack, 20 Tax Notes (1983) 771, 780.) As we have seen, *Container* emphasized repeatedly the distinction between domestic-parent and foreign-parent corporations. And, like *Container*, this case arises from California's application of the worldwide unitary method, indisputably the

most important state applying the method. (Langbein, 23 Tax Notes, supra, at p. 626.)

Now, it might be argued, the federal Justice Department attorneys are busy people and they cannot be aware of all the relevant cases being litigated across the land. There are several problems with this argument, however. The number of relevant cases is relatively small given the small number of states that have employed the worldwide unitary method. (In fact, California apparently is the only state currently using the method; of course, it too has now adopted a "water's edge" election. (See fn. 4, *ante*.) As noted previously, no one would dispute that California is *the* pivotal state on this issue given the sheer size of its economy and its more comprehensive application of the method. (See Langbein, 23 Tax Notes, supra, at p. 626; Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa Clara L.Rev. 123, 134.) And, of course, the "appropriate" nature of the present case cannot be denied. But most significantly, the United States Department of Justice was twice notified about this case by letters from Colgate's counsel. Two high-ranking Justice Department attorneys responded to those letters by stating that the position taken by the United States in *Barclays Bank of California v. Franchise Tax Board* — then pending in the Superior Court of California for Sacramento County (Nos. 325061, 325059) — and the position taken in *Alcan Aluminum v. Franchise Tax Board* and *Imperial Chemical Industries PLC v. Franchise Tax Board* — then pending in the United States District Court for the Northern District of Illinois (Nos. 84-C-6932, 84-C-8906, respectively) — remained the position of the United States.

These two letters from the Justice Department attorneys are the same two letters Colgate relies upon here to argue that the federal executive has indeed made its views known in this case and that an executive amicus brief or other statement of position is unnecessary. The problem for Colgate is that the

Barclays, Alcan and Imperial Chemical cases all involved the application of the worldwide unitary method to *foreign*-parent groups. (See *Franchise Tax Bd. v. Alcan* (1990) 493 U.S. 331, ____, 110 S.Ct. 661, 664, 107 L.Ed.2d 696, 702.) According to the Justice Department letters, the three cases "involved the appropriateness of taxation *of the plaintiffs* [i.e., foreign-parent multinationals] on a worldwide unitary basis under California law prior to the September, 1986, amendment thereto [*i.e.*, the "water's edge" election]. [¶] In those cases the United States filed briefs amicus curiae wherein it stated its position on the *above-stated issue*." (Emphasis added.)

A matter we can judicially notice supports our conclusion. We filed a decision in the Barclays case on November 30, 1990. (225 Cal.App.3d 1342, 275 Cal.Rptr. 626; ptn. for review granted 2/28/91.) In that action, the United States filed an amicus brief with this court. (Evid. Code, 452, subd. (d), 459, subd. (a).)[8] That amicus brief was authored under the supervision of one of the Justice Department attorneys who responded by correspondence to Colgate's counsel here. That brief stated in part: "It is the position of the United States Government, as reflected in the letter of ... Secretary of State [Shultz] to ... Governor [Deukmejian] [the same letter Colgate relies upon here], that the unitary tax is at odds with the 'arm's length' accounting method which is the international rule and standard, and that adherence to the 'arm's length' method of taxing corporations with foreign parents is essential to avoid adverse consequences for the foreign relations of the United States. (Letter.) ... *Container Corp.* involved the application of California's tax to a domestically controlled group of corporations and it was that issue on which the Federal Executive expressed no view. The Supreme Court in *Container Corp.*, as

---

[8] Compliance with Evidence Code section 455, subdivision (a) is unnecessary (Evid. Code, § 459, subd. (c)) because Colgate has relied on the United States' amicus trial brief in the Barclays case and has introduced and had admitted various parts of the Barclays record as part of the record here.

stated before, expressly reserved judgment on the issue *sub judice* in this case, and with respect to this issue the Federal Executive is filing a brief *amicus curiae* and is expressing its policy and position. In the instant case therefore, this Court should have no difficulty in determining the Federal Executive's views. The statements of the Secretary of State (Letter) and the President of the United States, (Statement) [the same statements Colgate relies upon here] demonstrate that the Federal Government has a clearly articulated policy in favor of 'arm's length' accounting in the conduct of foreign affairs, and that California's worldwide combined unitary business concept method is in conflict with the internationally accepted standard and policies, and custom, and this in turn has caused serious disputes and difficulties for the United States in the conduct of foreign affairs. Finally, precisely because of these foreign policy considerations and because of their gravity, the Department of Justice, at the direction of the President, is filing this *amicus curiae* brief." (Barclays C003388 U.S. Amicus App. Brief, pp. 31, 33-35.) As noted, we do not have any statement from the executive in the present litigation.

It also might be argued that the executive branch need not continually have to set forth its position. The President has issued an authoritative statement; the matter is settled; how many more times does something have to be said? Of course, the problem with this argument is that in the President's statement, the President instructs the Attorney General to ensure that the United States' interests are represented in appropriate cases consistent with the statement. The President's statement arguably covers domestic-parent groups and the executive branch was notified about this significant and appropriate case. Nevertheless, the executive branch here, as in *Container*, has chosen to remain silent.

In sum, the executive branch was twice explicitly notified about this case. This case could not have provided a more appropriate context for the executive branch to express its views

regarding the application of the worldwide unitary method to domestic-parent groups with foreign subsidiaries. The President's statement instructed the Attorney General to ensure that the United States' interests were represented in appropriate cases. Nevertheless, the executive branch has done nothing here to make its position known. Under these circumstances, we cannot say that President Reagan's statement either constitutes an authoritative expression of the federal government that application of the worldwide unitary method to domestic-parent groups with foreign subsidiaries implicates foreign policy issues which must be left to the federal government or constitutes a clear federal directive which California has violated here.

We now examine Secretary of State Shultz's 1986 letter to Governor Deukmejian. The purpose of this letter was to note that the Reagan Administration had proposed federal legislation prohibiting worldwide unitary taxation, but that similar action at the state level would be welcomed. Apparently this legislation would have prohibited the application of the worldwide unitary method to all multinational corporations, be they domestic-parent or foreign-parent. Nevertheless, Secretary Shultz's 1986 letter provides no stronger support for Colgate's *foreign commerce clause* position than did President Reagan's 1985 statement.

In that letter, Secretary Shultz states that "[t]he longstanding policy of the federal government has been to follow the separate accounting method. The United States has advocated and adopted the position that the 'arm's-length' adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed. This view is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties.

There is an important passage in *Container*, however, which calls into question the Secretary's statement in the domestic-parent context. As noted in *Container*: "[A]lthough the United States is a party to a great number of tax treaties that require the Federal Government to adopt some form of arm's-length analysis in taxing the domestic income of multinational enterprises, that requirement is generally waived with respect to the taxes imposed by each of the contracting nations on its own domestic corporations. This fact, if nothing else, confirms our view that such taxation is in reality of local rather than international concern." (463 U.S. at p. 196, 103 S.Ct. at 2956.) Thus, the longstanding policy and position expressed by Secretary Shultz — embodied in the Internal Revenue Code and a central feature in American bilateral tax treaties — apparently does not apply to the taxation of domestic-parent groups by their home countries but applies only to the taxation of foreign-parent groups.

The Secretary of State's letter further specifies that "[y]our state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states"; that continued state use of the worldwide unitary method "will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation"; and finally that "[t]he worldwide unitary issue has seriously complicated our economic relations with many of our closest allies."

In making these observations, however, Secretary Shultz relies primarily on factors illustrating that the foreign commerce problem is limited to foreign-parent groups and does not encompass their domestic-parent counterparts. For example, the Secretary notes the worldwide unitary method can impede foreign entry into the United States market. He discusses the administrative burdens of compliance, particularly

for foreign-controlled entities. He cites to the diplomatic notes received from many countries complaining about state use of the worldwide unitary tax method. Although the specific contents of these notes are not set forth, similar protests in *Container* were discussed in the exclusive context of the foreign-parent group. (463 U.S. at pp. 202-203, fn. 4, 103 S.Ct. at pp. 2959-2960, fn. 4.) Finally, the Secretary notes that British "anti-unitary retaliatory legislation" has been adopted denying *U.S.-parent* corporations operating in worldwide unitary states a very valuable benefit under the U.S.-U.K. Tax Treaty. From all of this, it is difficult to discern genuine executive branch concern — arising from issues germane to the foreign commerce clause — regarding state application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries.

That brings us to Treasury Secretary James Baker's 1986 letter to Senator Bob Packwood, chairman of the Senate Finance Committee. (An identical letter was sent by Secretary Baker to Representative Dan Rostenkowski, chairman of the House Ways and Means Committee.) This letter was sent "to describe the serious concerns that have led the [Reagan] Administration to propose and support [the] legislation" (alluded to in Secretary Shultz's letter to Governor Deukmejian).[9]

Those "serious concerns", however, are largely the same concerns noted in Secretary Shultz's letter: the longstanding policy of separate accounting embodied in the Internal Revenue Code and a central feature in the bilateral tax treaties; the diplomatic notes from countries around the globe complaining about state use of the worldwide unitary method; the British anti-unitary retaliatory legislation aimed at U.S.-parent multinational corporations; the administrative burdens of

---

[9] Congress never enacted this proposed legislation.

compliance, particularly for foreign-owned companies; and the barrier to foreign entry into the United States market. As we have seen, these matters illustrate that the foreign commerce problem involves foreign-parent groups rather than their domestic-parent counterparts. Consequently, these matters do not support Colgate's argument that California's application of the worldwide unitary method to domestic-parent groups with foreign subsidiaries is unconstitutional under the foreign commerce clause because it interferes with the conduct of American foreign policy.

This view is bolstered by Senator Pete Wilson's comments in the Congressional Record made during his introduction of the subject legislation in the Senate. Senator Wilson stated: "While the principal foreign commerce issues raised by State worldwide unitary taxation would be resolved if States were to agree that they would not impose worldwide unitary tax on foreign controlled entities, such [a] limited resolution would cause other serious problems. If a 'foreign only' solution were adopted, domestically controlled businesses would thereby be disadvantaged."

Secretary Baker's letter to Senator Packwood does note the Working Group's principle of "water's edge" (allocation methods restricted to United States boundaries) for both domestic-parent and foreign-parent companies in line with the Working Group's principle of competitive balance for all companies, whether domestic or foreign. The problem for Colgate in this appeal is that domestic-parent groups are included in the proposed restrictive legislation on "competitive balance" grounds rather than on the foreign commerce clause grounds set forth in *Japan Line* and *Container*. "Competitive balance" for domestic corporations is not an issue under the dormant foreign commerce clause "one voice" test created in *Japan Line* and refined in *Container*. (*Japan Line, supra*, 441 U.S. at pp. 456-457; see *Container, supra*, 463 U.S. at pp. 188-189, 195, fns. 26, 103 S.Ct. at pp. 2952-2953, 2956, fns. 26.)[10]

Under the "foreign policy implications" precept of *Container*'s "one voice" refinement, we must determine whether California's application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries "implicates foreign policy issues which must be left to the Federal Government." (463 U.S. at p. 194, 103 S.Ct. at p. 2955.) As we have seen, the President's statement, the two Secretary letters, and the two letters from the Justice Department attorneys show that the foreign commerce problem is essentially limited to foreign-parent groups and does not materially involve their domestic-parent counterparts. "Competitive balance" for domestic corporations is not part of the "foreign policy implications" issue. Therefore, the statement and letters from the executive branch officials do not constitute, either individually or collectively, an authoritative expression of the federal government that state application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries implicates foreign policy issues which must be left to the federal government.

Of course, our analysis is not confined merely to foreign policy implications. We must also consider whether the President's statement, the Secretaries' letters, and the Justice Department attorneys' letters constitute, individually or cumulatively, a clear federal directive violated by California here. The "clear federal directive" envisioned in *Container* does not exist in a vacuum, but is part of the foreign commerce

---

[10] In arguing for mandatory equal tax treatment for domestic-parent and foreign-parent groups, Colgate relies on *Star-Kist Foods, Inc. v. County of Los Angeles*, supra, 42 Cal.3d 1, 227 Cal.Rptr. 391, 719 P.2d 987. *Star-Kist*, however, recognizes *Japan Line*'s sanction of inequality if necessary to preserve the values embodied in the dormant foreign commerce clause. (42 Cal.3d at pp. 12-14; see fn. 13, *post*.)

clause "one voice" standard enunciated in that case. (463 U.S. at p. 194, 103 S.Ct. at p. 2955.) Arguably, then, the directive is in some way linked to issues of foreign commerce or foreign affairs. In the statement and letters at issue here, however, the state application of the worldwide unitary tax method to domestic-parent groups is not linked to issues of foreign commerce or foreign affairs. To the contrary, the statement and letters relegate those issues to the foreign-parent context. Moreover, the statement and letters, as analyzed above, are ambiguous regarding the domestic-parent context. Such ambiguity is inconsistent with a clear directive.

Nevertheless, one could also argue persuasively that *Container*'s "clear federal directive" precept need not be linked to foreign policy. This is because a genuine and authoritative clear federal directive must always be acknowledged, regardless of whether it was promulgated in the context of foreign policy or domestic policy. (U.S. Const., art. VI, cl. 2; Tribe, Amer. Const.Law, *supra*, Limits on State and Local Power, pp. 479-511.) But conceding this point does not help Colgate.

In *Container*, the court did not find any "clear federal directive" from Congress. (463 U.S. at pp. 196-197, 103 S.Ct. at pp. 2956-2957.) That situation has not changed since *Container*. (See fn. 9, *ante*.) We therefore are left with the executive branch as the source of the directive, assuming that branch can be the source. (See fn. 7, *ante*.) Our analysis has shown that this case, like *Container*, presents an essentially domestic issue. However, in the domestic policy arena — in contrast to the foreign policy sphere — the executive's powers and its ability to formulate policy are much more limited. (Tribe, Amer. Const.Law, supra, Federal Executive Power, §§ 4-2, 4-4, pp. 210-213, 219-225.) If the executive branch indeed has a clear federal directive on the domestic issue involved here, why has that branch not presented this court with an amicus brief or other affirmation of that directive? As we have seen, this is especially troubling given that the executive branch was twice

notified about this case, given that this case presents an extremely appropriate context for the executive to make its post-*Container* views known (be they domestic-oriented or foreign-oriented), and given that President Reagan's 1985 statement instructed the Attorney General to ensure that federal interests were represented in appropriate cases. The executive's failure here to assert any directive evidences either the lack of such a directive or the ambiguity of one, if one exists. When these circumstances are aligned against the fundamental concept of state sovereignty and the broad power of a state to tax (see *Hines v. Davidowitz* (1940) 312 U.S. 52, 68, 61 S.Ct. 399, 404, 85 L.Ed. 581, 587-588), the argument for a clear federal directive in this case evaporates.

Finally, in addition to its principal evidence analyzed above, Colgate relies on a federal district court case in Alaska filed in 1987 by the United States against the state of Alaska. Colgate alleges this case demonstrates the federal government's commitment to eradicate state use of the worldwide unitary method. Again, however, the Alaska suit involved the application of the worldwide unitary tax method to a *foreign*-parent group and it was on that basis the United States sought a judgment declaring the method unconstitutional. Rather than support Colgate's foreign commerce clause argument, the Alaska case undermines it.[11]

Because we conclude that the evidence relied upon by Colgate does not show any foreign policy implications or clear federal directives which alter the *Container* "one voice" analysis, that analysis remains valid in the context of this case. A few general observations buttress our position.

---

[11] The Board asks that we take judicial notice of a stipulation of dismissal in the Alaska action, based on a settlement. We do so. (Evid. Code, §§ 452, 459.)

In marked contrast to the record presented to this court in the Barclays case (*Barclays Bank v. Franchise Tax Bd.*, 225 Cal.App.3d 1342, 275 Cal.Rptr. 626 (ptn. for review granted 2/28/91)), the record presented here contains no statements, protests, or amici briefs from foreign governments or representatives of foreign interests. (Evid.Code, §§ 452, subd. (d), 459, subd. (a); see fn. 8., *ante*.) This is not really surprising, however. The difference between applying the worldwide unitary tax method to a domestic-parent group and applying it to a foreign-parent group is a distinction of significance in the context of foreign commercial relations and the "custom of nations." (See *Japan Line, supra*, 441 U.S. at p. 454, 99 S.Ct. at p. 1824.) This is because the worldwide nature of the tax method at issue falls ultimately on the parent corporation. It is the parent's worldwide income that is apportioned. It is the parent's worldwide operations that are scrutinized. It is the parent upon whom the worldwide administrative burden of compliance falls. By definition, the worldwide unitary method seeks the ultimate source of corporate responsibility and that source is the global parent. Unlike the domestic parent, the foreign parent is likely versed only in the separate accounting tradition, is likely unfamiliar with the concepts of federalism and genuine subnational sovereignty, and is often intimidated by the complexities of our multi-level system of government. In this context, foreign resentment of the worldwide unitary method is understandable. In contrast, the foreign subsidiary of a domestic-parent is merely a cog in the unitary wheel; the parent is the hub. Put simply, the foreign subsidiary of a domestic-parent is akin to a child who is not saddled with parental responsibilities.

Furthermore, although we are increasingly entering a global economy where national boundaries are less significant, there is still a nationalistic dignity associated with the "home base" of a multinational corporation. There is nothing unnatural about the assertion of this dignity. (See *Japan Line, supra*, 441 U.S. at p. 456, 99 S.Ct. at p. 1826.)

Presented in this case is the very line of federalism. On one side of the line is the federal government's rightful power to conduct foreign affairs without interference from the states. (See *Japan Line, supra*, 441 U.S. at pp. 448-457, 99 S.Ct. at pp. 1821-1826.) On the other side is the states' rightful power to tax as a separate sovereign. (*Hines v. Davidowitz*, supra, 312 U.S. at p. 68, 61 S.Ct. at p. 404.) In this fundamental clash of political power, we look to the two political branches of our national government to specify if a state's activity is jeopardizing foreign policy positions that are inherently national in character. (*Container, supra*, 463 U.S. at pp. 194-196, 103 S.Ct. at pp. 2955-2956.) Neither branch has specified foreign policy implications here. And the length of our "clear federal directive" discussion illustrates perhaps better than the discussion itself the lack of such a directive on the issue presented in this case. Nor can the federal government, as we have seen, plead ignorance about this case or claim the case presents an inappropriate context in which to state its views. In fact, here the federal executive did not see fit to follow its own pronouncement to make sure federal interests were represented in appropriate cases. In this posture, we cannot say that California's application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries is unconstitutional under the foreign commerce clause because it either impermissibly interferes with the conduct of foreign policy or violates a clear federal directive. In this light, *Container*'s conclusion remains valid that such "taxation is in reality of local rather than international concern." (463 U.S. at p. 196, 103 S.Ct. at p. 2956.)

Based on the uncontradicted evidence presented here, we hold that California's application of the worldwide unitary tax method to domestic-parent groups with foreign subsidiaries is

not unconstitutional under the foreign commerce clause of the Federal Constitution.[12]

3. Did California Unlawfully "Distort" the Amount of Colgate's Income Apportioned to California?

Although Colgate did not file a cross-appeal, it argues the trial court erroneously determined that California's application of the worldwide unitary tax method to Colgate did not unlawfully "distort" the amount of Colgate's income apportioned to California. We denied the Board's motion to strike this argument from Colgate's respondent's brief. Accordingly, we consider the issue.

Colgate's argument is premised on what *Container* described as the "external consistency" requirement of fairness in an apportionment formula. Under that requirement, the application of a tax apportionment formula, such as California's worldwide unitary tax method, must be fair to pass constitutional scrutiny under both the due process and the commerce clauses; stated another way, the formula must actually reflect a reasonable sense of how income is generated. (*Container, supra*, 463 U.S. at pp. 169-170, 103 S.Ct. at pp. 2942-2943; *Trinova Corp. v. Michigan Dept. of Treasury* (1991) 498 U.S. ___, 111 S.Ct. 818, 112 L.Ed.2d 884.) Under this constitutional edict, an appor-

---

[12] On constitutional grounds involving equal protection and the commerce clause, Colgate also argues that foreign-parent groups and their domestic-parent counterparts must be treated identically for tax purposes. We are not aware of any final decision holding that state application of the worldwide unitary tax method to foreign-parent groups is unconstitutional under the foreign commerce clause. Until such decision, this issue of equality is premature. There is a well-settled principle that courts do not consider constitutional issues that are not ripe for determination. (*Regional Rail Reorganization Act Cases* (1974) 419 U.S. 102, 138, 95 S.Ct. 335, 356, 42 L.Ed.2d 320, 350.) We adhere to that principle in this case and do not express any views on this issue. (See fn. 10, *ante*.) We do note that this issue was not litigated below in any meaningful fashion, was not part of the trial court's decision, and consequently has not been briefed adequately here.

tionment formula will be invalidated if the taxpayer can prove by clear and cogent evidence that the income attributed to the state is "'out of all appropriate proportion to the business transacted by the [taxpayer] in that State'" or has "'led to a grossly distorted result.'" (*Container*, supra, 463 U.S. at pp. 170, 181, 103 S.Ct. at pp. 2942, 2948; *Trinova*, supra, 498 U.S. at p. ___, 111 S.Ct. at p. 832-833, 112 L.Ed.2d at pp. 908-909.)

In addition to the constitutional "external consistency" requirement, there is a statute in California on the subject. Revenue and Taxation Code section 25137 provides: "If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable: [¶] (a) Separate accounting; [¶] (b) The exclusion of any one or more of the factors; [¶] (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or [¶] (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

Colgate argues that California's worldwide unitary tax method apportioned 70 percent more income to California in comparison to separate accounting and that such apportionment contravenes both the constitutional and the statutory distortion principles. We disagree.

As noted by one commentator in reviewing *Container*'s discussion of the constitutional distortion principle of "external consistency," the taxpayer's burden of proof on this issue is "steep if not insurmountable." (23 Columbia Journal at p. 457.) This is an accurate comment. In *Container*, the court noted that the three-factor formula used by California has not only "met our approval" but has become "something of a

benchmark against which other apportionment formulas are judged." (463 U.S. at p. 170, 103 S.Ct. at p. 2942.)

Container also noted the distortion figures in that case were based essentially on separate accounting methods that failed to account for the flow of value between the parts of the unitary business. (*Id.* at pp. 181-184, 103 S.Ct. at pp. 2948-2950.) The same can be said here.

Colgate argues the distortion arises here because Colgate's foreign subsidiaries are substantially more profitable than its California operations. That is, the foreign subsidiaries' lower property, payroll, and sale figures for the same level of productivity result in a distorted apportionment to California under the three-factor formula. In *Container*, the taxpayer made the same argument. The court in *Container* rejected this argument, stating: "The problem with this argument is obvious: the profit figures relied on by [the taxpayer] are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." (463 U.S. at p. 181, 103 S.Ct. at p. 2948.)

Apparently, there is only one United States Supreme Court decision that has invalidated a state tax apportionment formula applied to a corporate income tax or a franchise tax of a manufacturing or mercantile company like Colgate. (23 Columbia Journal at pp. 450-451; see also *Container, supra*, 463 U.S. at pp. 182-184, 103 S.Ct. at pp. 2949-2950.) That decision is from 1931 and is entitled *Hans Rees' Sons Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879 (1931). In that case, a one-factor unitary tax method was applied to a domestic company. Although the company's income in *Hans Rees'* was derived from a variety of far-flung activities — including buying, selling and manufacturing — North Carolina's statutory formula allocated the entire wholesale profit to North Carolina, where the manufacturing occurred. This allocation resulted in 250 percent more income attributed

to the state. (283 U.S. at pp. 126-128, 51 S.Ct. at pp. 386-387; see 23 Columbia Journal at p. 450; *Container, supra*, 463 U.S. at pp. 183-184, 103 S.Ct. at pp. 2949-2950.)

Colgate's 70 percent figure — which does not account for the flow of value between the parts of Colgate's unitary business — is not comparable to the 250 percent tally in *Hans Rees'*. Colgate has not met the steep burden imposed by the constitutional distortion principle of "external consistency."[13]

Colgate realizes this and pins its hopes on Revenue and Taxation Code section 25137. Colgate faces an uphill battle here as well. Under section 25137 and California case law, the Franchise Tax Board is given discretion to select the factors to be used in a tax formula. (*McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 Cal.2d 506, 512, 72 Cal.Rptr. 465, 446 P.2d 313.) Where a taxpayer petitions for an alternative formula under section 25137, the taxpayer bears the burden of establishing by clear and convincing evidence that the formula used by the Franchise Tax Board reaches an unreasonable result in his or her case. (*Ibid.*; Rev. & Tax.Code, 25137; *Communications Satellite Corp. v. Franchise Tax Bd.* (1984) 156 Cal.App.3d 726, 746-749, 203 Cal.Rptr. 779; see, e.g., *Firestone Tire & Rubber Co. v. County of Monterey* (1990) 223 Cal.App.3d 382, 387-388, 272 Cal.Rptr. 745.)

Colgate argues that the trial court used the constitutional "out of all proportion" test to dismiss Colgate's statutory assertion under section 25137. Additionally, Colgate argues that testimony from the Board's counsel for multi-state tax affairs establishes that the Board unlawfully fails to consider separate

---

[13] In a recent decision, the United States Supreme Court relied on *Container's* flow of value concept to uphold the application of the three-factor formula involved here to a value added tax on a unitary business. (*Trinova*, supra, 498 U.S. ____, 111 S.Ct. 818, 112 L.Ed.2d 884.)

accounting as an alternative for unitary companies under section 25137. Neither of these arguments has merit.

As noted by the Board, the trial court did not apply the constitutional "out of all proportion" test to the statutory issue. In reviewing the Board's denial of Colgate's section 25137 petition, the trial court cited *Container*'s "flow of value" concept and upheld the Board's determination that Colgate had not demonstrated by clear and convincing evidence that California's apportionment formula unfairly represented the extent of Colgate's business activity in California. (*Container, supra,* 463 U.S. at pp. 181-184, 103 S.Ct. at pp. 2948-2950.) This constituted a correct application of the statutory standard set forth in section 25137. (*McDonnell Douglas Corp. v. Franchise Tax Bd.*, supra, 69 Cal.2d at p. 512, 72 Cal.Rptr. 465, 446 P.2d 313; see *Amoco Production Company v. Arnold* (1974) 213 Kan. 636, 518 P.2d 453, 463-465.)

Citing *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163, 176, 116 Cal.Rptr. 160, Colgate contends the right to recover taxes paid under protest is a fundamental vested right; therefore, the trial court was obligated to exercise its independent judgment on the section 25137 evidence. We disagree with Colgate for two reasons. First, the *Hunt-Wesson* court did not hold that the right to recover taxes paid under protest is a fundamental vested right. That court said the argument could be made. (41 Cal.App.3d at p. 176, 116 Cal.Rptr. 160.) Second, and more importantly, the precise issue involved here concerns the application of a particular tax method that is within the discretion of the Franchise Tax Board under statutory directive. (*McDonnell Douglas Corp. v. Franchise Tax Bd.*, supra, 69 Cal.2d at p. 512, 72 Cal.Rptr. 465, 446 P.2d 313; Rev. & Tax.Code, §§ 25120-25139; Cal.Code Regs., tit. 18, § 25137-6; see *Amoco Production Company v. Arnold*, supra, 518 P.2d at pp. 463-465; see, e.g., *Firestone Tire & Rubber Co. v. County of Monterey*, supra, 223 Cal.App.3d at pp. 387-388, 272 Cal.Rptr. 745.) Colgate can hardly ascribe an individually "vested" status to this process. (See *Hunt-Wesson, supra,* 41 Cal.App.3d at p. 174, 116 Cal.Rptr. 160.) As noted, *McDonnell Douglas* is the relevant decision on this limited issue. (69 Cal.2d at p. 512, 72 Cal.Rptr. 465, 446 P.2d 313.)

Our resolution of the statutory distortion issue renders irrelevant Colgate's argument that the Board unlawfully fails to consider separate accounting as an alternative for unitary companies under section 25137. Colgate has not shown that California's apportionment formula unfairly represented the extent of Colgate's business activity in California. The alternatives set forth in section 25137 are invoked only if the taxpayer makes that showing. Consequently, we do not address this argument.

4. The Sanctions and Costs Issues

The Board claims the trial court abused its discretion in denying the Board's motion for sanctions against Colgate. In that motion, the Board argued that Colgate unduly delayed in producing certain documents evidencing the unitary nature of Colgate's operations.

This matter arose when Colgate, during the first two days of trial, belatedly produced to the Board's counsel five boxes of documents pursuant to the Board's requests for production of documents and a court order based on those requests. Included in this belated production were documents relevant to the operation of Colgate's Danish subsidiary and therefore relevant to the issue of whether Colgate's subsidiaries operated in a unitary fashion with the domestic parent corporation. This production occurred in mid-July 1988. It was not until mid-February 1989, however, that the Board moved for sanctions on this matter; this was after the trial was over and after the Board had won on the unitary issue. On these facts, the trial court declined to award sanctions because the motion was untimely and failed to evidence prejudice against the Board.

The trial court has broad discretion in imposing discovery sanctions, subject to reversal only for arbitrary, capricious or whimsical action. (See *Sauer v. Superior Court* (1987) 195 Cal.App.3d 213, 228, 240 Cal.Rptr. 489; *Kahn v. Kahn* (1977) 68 Cal.App.3d 372, 380-381, 137 Cal.Rptr. 332 [although these cases were not decided under the current discovery statutes, the general principle of review they enunciate remains valid. (*See* former Code Civ.Proc. § 2034.)].) Code of Civil Procedure section 2023, subdivision (b)(1), upon which the Board relies, does not alter this well-settled principle and the Board concedes as much. That section and subdivision provides in pertinent part that: "[i]f a monetary sanction is authorized by any provision of this article, the court shall impose that sanction unless it finds that the one subject to the sanction acted with substantial justification or that other circumstances make the imposition of the sanction unjust."

The Board argues that the trial court's finding of no prejudice conveys the message that it is acceptable to abuse discovery and conceal evidence, so long as the party seeking discovery cannot prove how those actions prejudiced its case. Of course, prejudice is difficult to prove in the face of victory. The Board's real concern is that such discovery abuse will go unpunished. The Board can rest assured that the trial court possesses an array of weapons to counter parties abusing the discovery process. These weapons include a "Monetary sanction," an "Issue sanction," an "Evidence sanction," a "Terminating Sanction," and a "Contempt Sanction." (Code Civ. Proc., § 2023, subd. (b)(1)(2)(3)(4)(5).) The problem for the Board here is that a timely motion for sanctions is required to make these sanctions effective. The Board made its motion after the trial was over and after it had won on the issue for which it sought sanctions. And the Board cannot claim it did not know about the discovery abuse until it made its motion in February 1989. The Board admits it uncovered the abuse in July 1988 during the first days of trial.

The Board argues it was prejudiced because it could have moved for summary judgment on the unitary issue had the documents been timely produced, and the trial could have been shortened if not eliminated. We doubt seriously that operational documents concerning one of Colgate's 75 foreign subsidiaries were the only evidence standing in the way of a summary judgment motion on the unitary issue. In any event, the nature of the unitary issue is essentially factual and particular to the corporate enterprise being examined. For that reason, the issue would not usually be amenable to summary adjudication resolution.[14] We also doubt that Colgate's timely production could have eliminated or significantly shortened the trial. The testimony part of the trial also encompassed the distortion issues, and the heart of the lawsuit concerned the foreign commerce clause issue.

The trial court did not abuse its discretion in denying the Board's motion for discovery sanctions.

Our partial reversal of the judgment renders moot the issue of costs awarded below to Colgate. Under our decision, Colgate is no longer the prevailing party.

DISPOSITION

The judgment on the foreign commerce clause issue is reversed. The judgment on the constitutional and statutory distortion issues and on the matter of sanctions is affirmed. The Board is awarded its costs on appeal.

PUGLIA, P.J., and CARR, J., concur.

---

[14] We note that Code of Civil Procedure section 437c was amended in 1990 to eliminate motions for summary adjudication of *issue(s)*.

APPENDIX F

COLGATE-PALMOLIVE COMPANY
Plaintiff,

v.

FRANCHISE TAX BOARD,
Defendant.

No. 319715.

Superior Court of the State of California.
for the County of Sacramento

Apr. 19, 1989.

BACKGROUND

During the years 1970-1973, plaintiff, a Delaware Corporation with New York headquarters, maintained a sales organization, a warehouse and a manufacturing plant for its products in California. In addition to its other U.S. activities Plaintiff owned a controlling interest in 75 foreign subsidiaries.[1] Therein lies the genesis of this controversy. In assessing the California franchise tax during those years, California used what is known as the world-wide unitary method of accounting. Plaintiff contends (1) that it was not a worldwide unitary organization; (2) that the apportionment of the income of Colgate and its foreign subsidiaries so distorted the business activity of Colgate in California that an alternative method should have been used; and (3) that the Board's unitary method was an impermissible interference with the federal government's power to conduct foreign affairs. It paid its taxes under protest, followed proper administrative procedures, and this suit ensued.

[1] The development of plaintiff's overseas empire is of some interest. It started before World War I and the majority of the more successful of the subsidiaries date back to a period before World War II. Those subsidiaries now account for a lion's share of plaintiff's income and hire over 16,000 people as against its 6,000 domestic employees.

The general practice has been to approach a local soap maker and with his local facilities and local knowledge develop a subsidiary. The subsidiaries are almost entirely manned by local personnel. However, the general manager is always an employee of plaintiff. The subsidiaries operate under the general control of the foreign division of the parent company but

Footnote continued...

I.

WERE PLAINTIFF'S FOREIGN SUBSIDIARIES PART OF A UNITARY BUSINESS?

Yes.

As will be developed later, plaintiff contends that the so-called world-wide unitary method of taxation accounting by defendant is unconstitutional. That issue will be discussed in a subsequent part of this decision. However, for a discussion of the present argument I will assume its validity and address plaintiff's contention that it is not a unitary enterprise. (I will use the word "plaintiff" loosely, usually meaning the mother company, not the foreign subsidiaries but may slip from time to time, leaving it to the good sense of the reader to make the proper application.)

There is certainly no "bright line" as to just what a unitary method of doing business is. Sometimes, as one reads the

Footnote continued from previous page.
are given a great deal of local independence in production, marketing and advertising, because experience has shown that this is the most efficient method of operating a foreign subsidiary.

cases, it seems that the distinction is in the eye of the beholder. For example, *Container* (*Container Corporation of America vs. Franchise Tax Board*, 436 U.S. 159 and *Woolworth* (*F. W. Woolworth Co. vs. Taxation and Revenue Dept.*, 458 U.S. 354) are not the easiest cases to reconcile. Nevertheless, in broad terms it can be said that for a world-wide unitary relationship to exist there must be a "significant functional integration", i.e. "a centralization of management and economies of scale" that contribute to the income of the subsidiaries. (*Mobil Oil Corp. v. Vermont* 445 U.S. 425.) All the activities carried on by the separate entities must be part of a single unitary business. The most recent U.S. Supreme Court effort to define the concept is to be found in *Container*:

> "... The functional meaning of this requirement (unitary business) is that there be some sharing or exchange of values not capable of precise identification or measurement..." (*Supra*, p. 166.)

and:

> "The prerequisite to a constitionally acceptable finding of a unitary business is a "flow of value, not a flow of goods." (*Supra*, p. 178.)

Considering this rather broad terminology, it is probably not too surprising that courts have come to some rather inconsistent results in applying these definitions to particular sets of facts.

The California Supreme Court has added its contribution to this effort to define a unitary business by recognizing *two* tests of unity. The first is the so-called "three unities test", i.e. that a unitary business is established by the presence of the unities of ownership, operation and use (*Butler Bros v. McColgan* 17 Cal.2d 664), and the "contribution or dependency test" of *Edison California Stores vs. McGolgan* 30 Cal.2d 472, under which a business is unitary if operations within California are dependant on or contribute to the operation of the business outside the state.

Accepting these rather broad standards, plaintiff contends it is not unitary, that the subsidiaries are viertually [sic] autonomous and that the relationship between it and its subsidiaries was no more than could be expected by the parent company and a wholly-owned subsidiary. Needless to say, defendant contends that the activities of plaintiff and its subsidiaries constitute a unitary business. I find that they do.

Plaintiff's efforts to picture its overseas empire as consisting of a group of sturdy little independent nations held together by a series of loose treaties crumble under the impact of the evidence presented in this case, particularly the evidence of Mr. Foster, the one-time C.E.O. of the organization, plus the storm of strong documentary evidence produced.

While it is certainly arguable and perhaps dispositive (if a reviewing court should so decide) that plaintiff's failure to raise this issue before the Board precludes its present presentation, I chose to reach the merits of the issue. In substance, defendant presented more than substantial evidence of control, exchange of knowledge and the substantial "flow of value" between Colgate and the foreign subsidiaries and among the foreign subsidiaries themselves. *Container* virtually compels this conclusion.

A.

Contrary to plaintiff's contention, the test is not whether the foreign subsidiaries were unitary with plaintiff's operations in California during the years in question. Rather, the test is whether California's activities were part of the overall unitary business. (*Honolulu Oil Corp. vs. Franchise Tax Board*, 60 Cal.2d 417.) (Plaintiff has conceded that its United States operations are unitary.) Nevertheless, irrelevant though the evidence may have been, there *was* evidence that the foreign subsidiaries received some material from California, that personnel from foreign subsidiaries visited the California operation, inferentially for educational purposes, and technical

studies done in California were shared with foreign subsidiaries. The necessary "flow of value" existed.

B.

The operations of the foreign subsidiaries were unitary with plaintiff's United States' operations.

For purposes of this discussion, I apply the "three unities" test of *Butler, Supra,* which has been approved by the United States Supreme Court and has actually been described as "something of a benchmark against which other apportionment forumlas are judged". (*Container, Supra,* p. 170.)

1. Unity of Ownership.

Here there is no issue. Plaintiff either owned the controlling shares or owned outright each of its foreign subsidiaries.

2. Unity of Operation.

The whole purpose of the International subsidiary corporation of plaintiff was to run the International business and to make sure that its policies were enforced. It had a headquarters in New York where its president was located. There were three vice-presidents, one for the Western Hemisphere, one for Europe, and one for the Far East. In every case the general managers of the foreign subsidiaries reported to these divisional vice-presidents. The record is replete with evidence of visits to subsidiaries by International personnel and between subsidiaries. The organization was more of a large and happy family than a collection of balkanized states.

Plaintiff furnished its subsidiaries with raw material, information and equipment; aided in engineering problems; developed specific accounting procedures and policies; guaranteed loans; and, according to Mr. Foster, transferred its personnel around to effect its worldwide objectives. It transferred general managers from subsidiary to subsidiary, shared in

marketing experience and expertise and, to a small extent, offered its rather meager research and development knowledge to the subsidiaries. However, clearly, research and development was basically the responsibility of the subsidiaries who sometimes whomped up whatever they wanted or were able to develop in their own locale. I hope I am not painting a picture of too centralized in [sic] operation. Admittedly, for good business reasons, the subsidiaries were given the maximum degree of autonomy consistent with the overall control by the parent company.

What has been said of the relatively modest offering of the research and development aspect of the parent company can be said of its legal help to the subsidiaries. It offered a modest but important advice in the fields of patents and trademarks.

3. Unity of Use.

On this issue, the testimony of Mr. Foster, former C.E.O. of the company was particularly devastating to plaintiff's case. He made it crystal clear (in the longest televised deposition I ever attended) that in the capacity of C.E.O. he gave direction and maintained control in almost every major aspect of the local and overseas' business. Again, while he allowed the subsidiaries the maximum degree of autonomy because experience had shown that this was good for business, there was never any doubt that Big Brother, in the form of the formidable Mr. Foster, was always there looking over the subsidiary's shoulder.

He appointed, and could fire, the president of International who in turn appointed the division vice presidents who in turn hired and fired the general managers of the subsidiaries.

The budget review process is a good example of close supervision and control as was the requirement for approval of work orders and numerous other activities requiring approval

of the parent company. It would unduly prolong this discussion to recite each of these items. Suffice to say, the record is replete with examples of a well-organized and carefully carried out program of control by the parent company, while at the same time allowing the greatest degree of autonomy possible.

C.

It is clear that the "three unities" test has been met. At this point, the *Container* case answers any questions regarding the constitutional due process standards for state taxation.

Under these standards, the due process and commerce clauses of the U.S. Constitution do not allow a state to tax income arising out of interstate activities, even on a proportional basis, unless there is a "minimal connection" or "nexus" between the interstate activities and the taxing state. There must exist "a rational relationship between the income attributed to the state and the intrastate value of the enterprise". (*Container, Supra*, p. 159.) *Container* also held that "the prerequisite of a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods." (*Supra*, p. 178, emphasis in original.) *Container* also held that the contributions of income from the subsidiaries should result from "functional integration, centralization of management and economies of scale". (*Supra*, p. 178-179.) Last, *Container* held that the taxpayer has the burden of showing by "clear and cogent evidence" that the state tax results in extraterritorial values being taxed.

There is nothing to be gained by further discussion in this area. Suffice to say, the evidence of unitary business operated by plaintiff in this case is substantially stronger than that of the taxpayer in *Container*. *Container* is simply too strong a case on this issue for the plaintiff to overcome on the evidence presented in this case. If the Container Corporation was unitary, plaintiff simply has to be.

Plaintiff's reliance on *F.W. Woolworth Co. vs. Taxation and Rev. Dept.* 458 U.S. 354 is misplaced. In *Woolworth* "no phase of any subsidiary's business was integrated with the parent's." (*Supra* p. 365, emphasis in original.) *Container*, which on its facts was weaker on this issue than ours, distinguished its facts from *Woolworth*. (*Supra* p. 159.)

Plaintiff loses on the unitary argument.

II.

DOES THE APPLICATION OF THE "THREE-FACTOR" APPORTIONMENT FORMULA (PAYROLL, PROPERTY AND SALES) TO THE COMBINED INCOME OF COLGATE AND ITS FOREIGN SUBSIDIARIES VIOLATE THE "DISTORTION DOCTRINE"?

No.

Here, plaintiff is again confronted with the holding of the Supreme Court in *Container* where the Court on remarkedly similar facts found for the taxing agency.

The unitary concept recognizes that a unitary business must be treated as a single unit and that income cannot be segregated along geographic or corporate lines within the business.

In *Container*, the taxpayer made the identical argument made here, i.e. that its foreign subsidiaries were more profitable than the domestic parent company and that the three-factor formula ignored differences in profitability by its reliance on indirect measures of income such as payroll, property and sales. There, the taxpayer argued that the three-factor formula failed to account for differences in profitability and thus distorted the true division of income between the foreign subsidiaries and the parent entity.

The Court rejected this contention saying that "the profit figures relief [sic] on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." (*Container, Supra*, p. 181.) The Court went on to say that "formal accounting is subject to manipulations and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." (*Supra*, p. 164-156 [sic].) The Court observed that some kinds of formula apportionment have weaknesses because they focus on too small an aspect of the company's activities but that the three-factor formula has gained acceptance simply because its factors (Payroll, property and sales) "appear in combination to reflect a very large share of the activities by which value is generated." (*Supra*, p. 182-183.)

There, as here, the taxpayer argued that the differences in wages and productivity among domestic and foreign entities should be used to attack the three-factor formula. The Court said, "The problem with all this evidence, however, is that it does not by itself come close to impeaching the basic rationale behind the three-factor formula." (*Container, Supra*, p. 182.) The Court held that the margin of error inherent in the three-factor formula is no greater than the margin of error inherent in "the sort of separate accounting urged upon us by appellant." (*Supra*, p. 184-185.) (See also *John Deere Plow Co. vs. Franchise Tax Board*, 130 Cap.App.3d [sic] 15.) *Container* concluded that although "separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." (*Supra*, p. 181.)

On greatly similar facts, *Container* rejected each and every contention made by plaintiff in this case. Nothing would be gained and it would unduly lengthen this decision to dissect each and every contention made in this case and rejected by

Container. That case simply shoots down in flames each and every contention made by plaintiff on this issue.

The foregoing discussion of the first two issues in this case are those [sic] which I used in my Intended Decision filed earlier. When the time came for counsel to file proposals for content of decision, my discussion of Issue I, the Unitary Issue, passed with flying colors, each party accepting it and agreeing that my intended decision serve as the Statement of Decision on this issue. Not so on the remaining two issues.

As to Issue II, the Distortion Issues; Defendant finds itself satisfied with the foregoing. Not so with the plaintiff, which has some suggestions for separate specific findings, some of which sound suspiciously like interrogatories and some of which request findings of evidentiary rather than ultimate facts. However, some deserve further comment.

In my discussion of this issue, I took a shortcut and simply adopted much of the language and all of the rationale of *Container* because I felt that that language and that rationale answered completely each of plaintiff's contentions. However, my shortcut was too short for plaintiff. As plaintiff points out, *Container* was concerned only with the distortion analysis under the Constitution and did not involve Section 25137. (See Footnote 3 in *Container*.) Nevertheless, I thought and still think that *Container's* discussion of the distortion doctrine was so persuasive that it answered plaintiff's contentions whether addressed to the Constitional issue or Section 27135. That was my intent and to make the matter clear beyond any doubt, I now specifically hold that the rationale in *Container* provides an adequate answer to plaintiff's contentions re: Section 25137. That rationale, as applied to the facts of this case, support [sic] the finding of the Board on the Section 25137 issue. Specifically, I find that Section 25137 does provide for modification of the standard formula where that formula does not fairly reflect the extent of the taxpayer's business activities in

the state. Also, Section 25137 lists separate accounting as an alternative to the three-factor formula when that formula does not fairly reflect the extent of the taxpayer's business activities in the state.

I further find that separate accounting may under some circumstances be used as an alternative to the normal apportionment formula where the taxpayer is part of a unitary group.

I further find in regard [sic] the taxable income, California apportionment percentage, California business income and total franchise tax under the three-factor apportionment formula as applied by the defendant board to the worldwide combined group, that the following computations are accurate:

Income Year	Taxable Income	California Apportionment Percentage	California Business Income
1970	$ 91,566,729	4.42075%	$4,047,936
1970	108,177,612	4.12017%	4,457,101
1971	123,779,352	4.03444%	4,993,803
1973	151,585,860	3.71812%	5,636,144

Income Year	Franchise Tax
1970	$283,356
1971	311,997
1972	379,529
1973	467,800

I also find the following to be the taxable income, California apportionment percentage, California business income and franchise tax resulting from application of the water's-edge separate accounting approach presented by Colgate in this case:

Income Year	Taxable Income	California Apportionment Percentage	Business Income
1970	$25,652,055	9.31920%	$2,390,566
1971	27,520,141	9.01730%	2,481,574
1972	32,440,358	9.21640%	2,989,833
1973	36,554,060	8.88730	3,248,669

Income Year	Franchise Tax
1970	$167,340
1971	173,710
1972	227,227
1973	269,640

I also find that utilization of worldwide apportionment by defendant board increases plaintiff's taxable income by approximately 70% for the years 1970 through 1973 over plaintiff's taxable income as computed on a water's-edge combined apportionment. This is simply a mathematical result of combining stipulated figures but is somewhat meaningless since it fails to reflect operational interdependencies, economic inter-

dependencies and functional integration between and among Colgate's worldwide unitary business.

I also find that plaintiff's labor cost and property cost per unit of product are substantially less than the comparable costs for the foreign subsidiaries. Again, this becomes rather meaningless since it fails to reflect the flow of value concept of *Container*.

I also find that the foreign subsidiaries were more profitable than plaintiff's domestic operations, again with the above caveat.

I further find that the normal three-factor apportionment formula does not necessarily produce an exact representation, in an economic sense, of the separate incomes of related entities. Neither, necessarily, does the separate accounting method. Both are imprecise.

Having made the specific findings that plaintiff has requested, we now find ourselves back at square one, plaintiff still loses on this issue. As I said originally, *Container* shoots down in flames each and every contention made by plaintiff on this issue.

It is to be remembered that the issue presented to me is whether the Board properly exercised its discretion in denying plaintiff's petition. Once it has exercised its discretion within the scope of the statute, that decision will not be disturbed by this court unless the court can find an abuse of discretion, an uphill battle under the best of conditions. Here, the Board held two hearings — the board itself not the staff. The Board found that plaintiff had made no showing that the standard apportionment formula unfairly reflected the extent of plaintiff's business activities in California. It also found that plaintiff used impermissible separate accounting measures in attempting to establish distortion. I cannot, on the basis of the record before me, overturn those findings.

I will not repeat the discussion of this issue as set forth in pages ten to twelve of this Statement of Decision. *Container* made it clear that no system is perfect, imperfection is build [sic] into both, formal accounting is subject to manipulation and imprecision and often "ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." (*Container*, p. 181.) Here we had the testimony of a believable expert that plaintiff's methodology failed to reflect that same flow of value from the domestic operations to the foreign subsidiaries.

Realistically, when one accepts, as indeed we must, *Container's* flow of value rationale, it becomes apparent that the taxpayer faces an extremely uphill battle in showing distortion. All I can say is that there was not displayed to me substantial evidence of distortion under the rationale of *Container*. The distortion that was shown is well within the level found acceptable by *Container*. The board acted well within its discretion in ruling against plaintiff on the distortion issue.

Having disposed of the two issues rendered relatively simple by *Container*, I proceed to the real meat of this lawsuit, the constitutional issue.

It is to be remembered that at the start of trial, I suggested to counsel that the issues be bifurcated and this issue be disposed of first because, should I rule for the plaintiff on this point, the other issues become moot. However, it was agreed that all issues be tried and decided because of the age of the litigation and the great expense already incurred in preparation. Thus, should I rule for plaintiff on this issue and should, by some horrible miscarriage of justice, a reviewing court disagree with me, the other two issues would be ripe for review. I now proceed to the constitutional issue.

III.

DOES DEFENDANT'S UNITARY METHOD OF TAXATION OF MULTINATIONAL CORPORATIONS IMPERMISSIBLY INTERFERE WITH THE FEDERAL GOVERNMENT'S POWER TO CONDUCT FOREIGN AFFAIRS?

Yes.

On this issue, the defendant, having won two battles, now loses the war. To be more accurate, the issue on which it loses was decided some two hundred years ago when thirteen highly independent former British colonies decided to abandon a confederation type of government and become the United States of America and, in so doing, adopted a new, vital and strong Constitution.

When these fledgling states adopted the new Constitution, they gave up certain rights. Among them was the right, as individual states, to regulate commerce with foreign nations. Now, only the new Federal Government could do so (Art. I., Sec. 8, *United States Constitution*.) Under this new Constitution, the country could speak with only one voice in dealing with foreign nations, not thirteen (or fifty) voices. Any state practice which impaired federal uniformity where federal uniformity was essential became unacceptable under this new system of government. In our case, California's application of the unitary method of taxation to a multinational corporation conflicts directly with the foreign policy of the federal government which is that the separate accounting, or water's edge, or arm's length accounting, is the appropriate method.

The unitary method of taxation is not widely used. In international circles it is not used at all in the taxing of multinational corporations. The water's edge method is now used. Even California has all but abandoned the unitary method of taxing multinational corporations since the taxpayer now has

his choice of methods and it is highly doubtful that a case such as this will ever arise again.

In the water's edge method the income of the foreign subsidiary is not thrown into the computation. Under it, multinational corporations pay less state taxes. However, for policy reasons involving the concept of free trade and with which we may not concern ourselves, the water's edge accounting method is now the expressed policy of the executive branch of the federal government. As a necessary corollary, it is also the expressed policy of the executive branch of the federal government that states not use the world-wide unitary method of computing taxes of multinational corporations. The President of the United States has said so. (Exh. 1.) So has the Secretary of State. (Exh. 2.) So has the Secretary of the Treasury. (Exh. 3,4.) And, last but not least, so has the Attorney General. (Exh. 5, 9 20.) Their objections to the unitary method can be summaried as:

(1) It impermissibly interferes with the conduct of foreign affairs by the executive branch of the federal government.

(2) It has caused conflicts between the United States and foreign nations and has led to the adoption of retaliatory legislation.

(3) It contravenes established federal policy in the field of foreign affairs.

It is well established that a state cannot act in such a way as to prevent the federal government from "speaking with one voice" in international affairs. (*Japan Lines vs. The County of Los Angeles*, 441 U.S. 434.) As the court in that case said: "California cannot tell this nation nor Japan how to run their foreign policies." Obviously, each of the fifty states cannot go merrily on its way establishing foreign policy. Otherwise, we

go back to the confederation. This principle is so obvious that it deserves no further comment.

Container, which effectively won defendant's first two contentions in this case, neatly dodges this issue by saying that the position of the federal government had not been made clear because it had not filed a brief in that case. (*Container, Supra*, footnote 33.) The dissent thought this had been established and chided the majority for not facing up to it. In our case, the position of the executive branch of the federal government is now crystal clear.

Defendant poo-poos the statements of the executive position on this issue as being mere press releases and letters. True. However, they are mighty strong and explicit press releases and letters. They clearly express the policy of the executive branch. It is their substance that counts, not their form. I think they clearly express executive policy on this issue.

In his public statement on this subject, the President of the United States instructed the Secretary of the Treasury to pursue through legislation and the Attorney General to pursue through litigation, the federal policy that multinational corporations be taxed by states only on income derived from the United States and not on income derived from foreign subsidiaries, i.e. the unitary method. Interestingly, the statement does not distinguish between cases involving U.S. parent corporations and those involving foreign parent corporations. The condemnation of the world-wide unitary method applies to all instrumentalities of foreign commerce, not just foreign based corporate groups. Actually, when the principles of water's edge accounting are accepted, it is difficult to rationalize any distinction. I can't. I find that the so-called "U.S. vs. foreign corporations" issue is a non-issue.

The letter from the Secretary of State to the Governor of California minced no words. Not only did it say that it was the longstanding policy of the United States to follow the separate

accounting method but that, "Your state's employment of the world-wide unitary method of accounting is at odds with the position of the United States and has become a source of conflict with foreign states." The letter of the Secretary of the Treasury further detailed the detrimental effect of the continuance of the world-wide unitary method on United States foreign policy.

The Attorney General has been carrying out executive policy in filling [sic] *amicus curiae* briefs on the subject in some cases and, in Alaska, which follows the California system, has even filed a lawsuit seeking a determination that the unitary method is unconstitutional on the specific grounds urged here.

But, say the defendants, the Attorney General has not filed a brief in this case. True. Instead, that office wrote two letters which simply stated that the positions expressed in prior briefs still expressed its views. One could speculate until doomsday just why the Attorney General took this tack. The bottom line is that he still made the position of that office and the executive branch of the federal government clear on this issue.

On this record it is impossible to say that the executive branch of the federal government has not spoken clearly. It is the policy of the United States, speaking through the executive branch, that the water's edge system be followed and the unitary method discarded. One would think that in view of the commerce clause and *Japan Line*, the discussion would be pretty conclusively ended. Not so.

Defendant contends that *Wardair Canada vs. Florida Department of Revenue*, 447 U.S. 1 compels a ruling in its favor on this issue. Not so.

Wardair involved a challenge by a Canadian airline operating charter flights to and from the United States to a Florida tax imposed on all aviation fuel sold within that state. Under the Florida law, an airline was liable for the full amount of the

fuel tax, whether the fuel was used to fly within or without Florida, and regardless of whether the airline was engaged in a substantial or nominal amount of business in Florida. The *Wardair* court affirmed the validity of the Florida law, holding that the federal government had affirmatively acted in such a way as to permit the state tax in question by enacting legislation which permitted state taxes on sales or use of goods or services in connection with air commerce. The court said:

> "In the present case, not only is there no indication of airline fuel that Congress wishes to preclude a state sales taxation of, but, to the contrary, the Act expressly permits states to impose such taxes."

(*Supra*, p. 6.)

Here, the federal government, acting through the executive branch, has acted affirmatively in showing a federal determination that the tax in question is contrary to federal policy.

Next, defendant argues that *Container* is controlling on this issue and that the analysis by *Container* of the commerce clause compels a ruling in its favor on this case. Not so. *Container* made it very clear that it based this aspect of its ruling on the fact that the federal government had not taken a position on this subject, a holding with which the dissent took issue. I repeat, *ad nauseam*, the executive branch of the federal government has now made its position clear and that, if the executive branch has that power, this is now the national policy on the subject.

And so, at long last, we come to the decisive question. Can the executive branch of the federal government establish national policy by itself or does it need the concurrence of the legislative branch? I think it can — and without the concurrence of the legislative branch.

Without question, the *legislative* branch can establish national policy without the concurrence of the executive branch.

The legislative branch is the pre-eminent branch of the national government. It can express policy and the executive branch must carry out that policy whether it likes it or not. If congress declares ware [sic] on the Kingdom of Tonga, the President goes to war with Tonga, period. We have recently been exposed to a classic example of legislative pre-eminence in the so-called "Contra affair." The executive branch was gung-ho for aiding the Contras and did so with great enthusiasm until congress acted to the contrary, at which point the aid came to a screeching halt — or at least — was supposed to. But how about the period before congress acted? Did the failure to act indicate congressional approval of executive policy? I doubt it. Did it express disapproval? Again, I doubt it. I don't think one can read anything into that congressional inaction. But once congress acted we *knew* what the national policy was and the executive branch was bound to follow that new national policy whether it liked it or not.

In our case, we have a strong position taken by the executive branch, which, for reasons which cannot concern us, has established a policy in the field of foreign commerce it feels will aid it in its relations with foreign nations. Only a few states (now only Alaska) stood in the way of this nation "speaking with one voice" in expressing and carrying out that policy. Is that policy now fatally flawed because congress has not acted? No way.

If Congress were to enact legislation to the contrary, that would end the matter. It has not. Failing to find active congressional support for its position, defendant falls back on a theory that in enacting certain legislation in this field or approving treaties in this field, congress has omitted from that legislation or those treaties or struck from them, language which would support the position of the executive branch in this field. From this congressional "action" defendant asks me to find that there is no federal policy in this field. This I cannot do.

In the first place, I have difficulty reading too much into any failure of congress to enact legislation. Trying to ascertain legislative intent after affirmative action by the legislature is bad enough. At least we know that the legislature has acted and now we have to try and find out what it meant by that action. However, when the legislature doesn't act, I have great difficulty in reading into that inaction any controlling policy. Congressional silence is a weak reed on which to lean. (Incidentally, for what it's worth, I agree with the defendant in its analysis of *Hampston vs. Mow Sun Wong*, 426 U.S. 88. There the executive branch *had* legislative authorization for its' [sic] action.)

Defendant says such a ruling would nullify the constitutional system of checks and balances which, for example, requires Senate approval of all treaties negotiated by the executive branch. Granted, the executive branch cannot enter into a binding treaty without Senate approval. But does that mean that each and every act of the executive branch which may express national policy in the international field needs congressional approval before it can truly express national policy? I think not. I haven't the foggiest idea of the innumerable positions the executive branch of the federal government must take in the fields of international relations or foreign commerce on an almost day-by-day basis, but to me it is pretty obvious that it can't run to congress on every one for approval or disapproval. For example, as *Witkin* says (*5 Witkin, Summary of California Law*, 8th Ed. p. 3974) "While treaties require the consent of the Senate, international compacts such as protocols, postal conventions and commerce agreements under the Tariff Act, are negotiated by the executive branch without senatorial consent. A compact is an exercise of federal power over external affairs and has the same supremacy as a treaty over state laws and policy. (*U.S. v. Belmont*, 301 U.S. 324; *U.S. v. Pink*, 315 U.S. 203)."

But, says the defendant, in this case we have much more than just legislative silence, we have a history of legislative inaction which actually amounts to action. For lack of a better phrase, I would classify this theory as one of dynamic inaction or affirmative silence.

Defendant lists five examples of legislative inaction which amount to dynamic inaction or affirmative silence. These, defendant contends, amount to positive action to the extent that they establish a legislative policy in favor of allowing the states to use the unitary method rather than the water's edge method of taxation of multinational corporations. Thus, we see that we have proceeded from the theory that the executive branch cannot establish federal policy without Legislative concurrence to a theory that in this case we have a history of legislative inaction that affirmatives create a federal policy. While the theory has a certain cosmetic appeal, I can't buy it.

Plaintiff in its closing brief has accurately and fairly listed the item [sic] of evidence on which defendant relies in support of this assertion. They are:

(1) Failure to consider state taxes at all in any income tax treaties with foreign countries.

(2) Failure to obtain the necessary two-thirds vote to ratify a treaty containing a provision prohibiting use of the worldwide unitary method by the states.

(3) The absence of any provision restricting state taxes of any sort in various model income tax treaties.

(4) The absence of restrictions on state taxation in Friendship, Commerce and Navigation Treaties to which the United States is a party.

(5) the absence of enacted congressional legislation prohibiting or restricting the world-wide unitary method.

Of these, the incident that most graphically articulates and is most supportive of defendant's position is the tax treaty with the United Kingdom which would have prohibited the state's use of the world-wide unitary method. When the negotiated treaty came before the Senate for ratification, the Senate refused ratification with that article included and ratified the treaty only after that provision was deleted. From this, defendant contends that the Senate action on the offending clause demonstrates there "is a long-standing federal policy to allow the states to use world-wide unitary method without federal interference." I am unimpressed.

The executive branch of the federal government is monolithic. It truly speaks with one voice in setting policy. When the President speaks, that *is* the voice of the executive branch. But until the legislative branch takes affirmative action after a consensus has been reached and passes a resolution, enacts legislation, ratified [sic] a treaty or declares war, it is a hydra-headed monster consisting of hundreds of individual voices, each of which has its own reason for speaking. It is a figurative Tower of Babel until a majority of those voices joint [sic] together in a chorus. Until that time, a single legislator or even a group of legislators cannot establish legislative policy.

Pending affirmative action by the majority, or two-thirds, we can only speculate as to the reason that less than a majority or less than two-thirds, did not act. Does it mean that the legislature is postponing action? Does it indicate legislative indifference? Is it a political gambit to embarrass the Executive? Is the legislative branch simply giving the executive branch enough rope to hang itself? Does it indicate that the legislative branch is waiting for a more politically propitious time to act? Does it indicate Legislative approval by its silence? Does it represent legislative disapproval? Does it mean an intent to act in the future? Are political debts being paid off?

The possibilities, the political nuances, are endless. In trying to assess legislative inaction or failure to act, we get into fields of pure speculation. We try to weigh imponderables. We quibble, we split hairs, we guess, we surmise, we pick nits. Trying to define or identify legislative policy from inaction is hazardous to the extreme.

I just can't read any policy statement into legislative inaction or failure to act. Attempting to do so would result in complete chaos as we try to read into congressional inaction any policy, in this case, one that would clearly express executive policy.

In other words, I don't know why congress failed to enact the legislation or struck from the legislation the language it did in the above five categories. I certainly can't find a legislative policy from that inaction. Once policy has been established by affirmative majority action, we need not bother ourselves by trying to guess why the action was taken. At that time the reason for the policy becomes irrelevant except from the standpoint of eventual statutory interpretation. I can't read federal policy into all or any of the five examples. If congress wanted to express a policy contrary to that expressed by the executive branch it could easily have done so. It hasn't. If the legislative branch had a policy of allowing the states to use the world-wide unitary method without federal interference it could easily have done so in any or all of the listed legislation treaties. One simple sentence in any of these would have shown legislative policy to that effect. One can search these pieces of legislation and those treaties in vain for any such statement of legislative policy.

In summary, I find that the executive branch of the federal government has clearly expressed a federal policy supporting the principle of water's edge taxation of multinational corporation and disapproving the world-wide unitary method, that the executive branch can do so without legislative concurrence

and that the legislative branch has not expressed a contrary policy. Thus, inescapably, defendant's unitary method of taxation of multinational corporations impermissibly interferes with the federal government's power to conduct foreign commerce and is thus unconstitutional.

Again, the foregoing is simply a copy of my Intended Decision filed earlier. As might be expected, Plaintiff accepts it in its present form and, I dare say, would compare it favorably with the best work of Oliver Wendell Holmes. It has been my experience throughout the years that winning lawyers are inclined to look more favorably at a judge's offerings than the losing lawyer. Strange.

However, defendant requests some specific findings, most of which I think are to be found buried in the foregoing flow of judicial rhetoric but, as I did with the plaintiff, I will attempt to make specific findings as requested, at all times watching my footsteps as carefully as possible to avoid getting a tad of reversible error in the record by way of an inconsistent finding. There is a wide-spread feeling among trial judges that this is usually the reason for requests for specific findings by the losing party. In this case, I hold no such such suspicion concerning counsel for the defendant, nor do I concern [sic] requests of plaintiff's counsel for findings on Issue II.

First, defendant asks, if such interference (interference with the federal government's power to conduct foreign affairs) exists, what precise policies of the Federal Government are interfered with by the application of the unitary method of taxation of domestic-parent multinational corporations.

Answer: That policy of the Federal Government that multinationals — whether domestic-parent or foreign-parent — be taxed by states only on income derived from the territory of the United States — the so-called waters edge method of taxation, not by the application of the so-called unitary method used by certain states.

Next, plaintiff requests specific findings on a series of related questions. (1) what date or dates were the policies specified above adopted by the federal government and which items of evidence establish such adoption? (2) if such interference does exist, what date was such interference manifested? (3) if such interference does exist, which items of evidence show such interference?

Plaintiff objects to this request pointing out that these issues were not "controverted issues" at trial, that Sections 632 and 634 of the Code of Civil Procedure relate only to a statement of decision on controverted issues and since this was not a controverted issue, no further statement is necessary.

There is certainly merit to plaintiff's position. These issues were not even mentioned, let alone litigated at trial although I must admit that I was a bit puzzled that the defendant didn't bring it up.

I really thought that when plaintiff introduced the exhibits showing the actions of the Federal Government in setting forth this policy in the 1980's, the defendant would say something to the effect that although this may have been the articulated policy during the 1980's, there was no evidence that that policy existed during the taxable years in question — 1970-1973. However, I was never one to try to tell lawyers how to try their lawsuits so I decided that if the lawyers thought this was a non-issue, it was a non-issue. Now, somewhat belatedly, defendant attempts to make this an issue. I repeat, I have again read and reread defendant's pre-trial and post-trial briefs and still cannot find a single word making this an issue. In all honesty and fairness, it does appear that if defendant was to make this a "controverted issue" it should have done it long before the Intended Decision was filed. Then, if I thought it had merit I might well have re-opened the case to explore this issue.

However, in answer to this defendant contends, as might be expected, that plaintiff, the party with the burden of proof,

was required to show both the fact of interference with foreign policy, and the relationship of that interference to the tax years in question. It points out that *Container*, issued in 1983, held that at that point in time there was no constitutional interference with federal policy. Of course, *Container* made no such holding. It simply dodged the issue. I should point out that in *Container* the taxable years in question were 1963-1965, and I haven't the foggiest idea whether this was ever made an issue as that case wended its way through the courts.

Nevertheless, it is clear to me, and I now find, that the only reasonable inference I can draw from the record in this case, that the policy existed long before the taxable years in question. Certainly, the Supreme Court in *Container* didn't seem much impressed with this as an issue. I turn to that record.

In 1985 and 1986, probably in response to *Container* which must have come as something of a shock to the Federal Government when it dodged this issue, that government, just to set the record straight, issued a series of statements setting forth its policy in no uncertain language.

On November 8, 1985, the President issued his statement supporting the concept of water's edge taxation and advising that since some states had not accepted that principle he had advised certain of his subordinates to see to it that that policy was carried into effect by the states.

I doubt that on the morning of November 8, 1985, Ronald Reagan woke from a tranquil sleep and said to himself, "By George, I have just had a new, novel and remarkable revelation. The unitary method of taxation used by some of the states, to the embarrassment of the Federal Government, must go!" Rather, the only reasonable inference I can draw is that a longstanding federal policy in this regard was being ignored by certain states to the chagrin of the federal government in its relations with other commercial nations and the President de-

cided it was high time those states get in line with that federal policy, particularly after the *Container* decision.

That inference is reinforced by the letter of the Secretary of State to the Governor of California of January 30, 1986 to the effect that it had been the *"longstanding policy"* of the Federal Government that the water's edge method of accounting be used and it was his request to the Governor of California that this state please join the Federal Government in this respect.

Then, on March 5, 1986, the Secretary of the Treasury Department wrote the Chairman of the Senate Finance Committee reiterating the inconsistency of the world wide unitary method used by some states with the *"longstanding"* United States foreign policy and emphasizing that the California method was inconsistent with that federal policy. At that time, there were still seven states using the unitary method — there had been more — but the federal program was apparently working insofar as getting rid of the troublesome states because as of now only one state, Alaska, is still holding out and the Attorney General, by litigation, is now trying to get that state in line. The only reasonable inference I can draw from this record is that the federal government has indeed had a longstanding policy in this respect and has been engaged in a long range program to do away with the unitary method.

This, "longstanding policy" that has been the policy of the federal government in its relations with other commercial nations is the one used by the Internal Revenue Code for many years and is the one used in all the bilateral tax treaties entered into between this nation and the commercial countries of the world dating back to the 1950's although these treaties obviously speak only to the federal government's policy. I doubt that such a treaty could be binding on a state. Rather, the federal government had to reach the states by persuasion and/or

litigation to get them in line. This is going and has been going for a long time.

On this record I cannot fix the precise date on which this federal policy was established. Like Topsy, it "just growed." In general, I presume that it came into being shortly after World War II and the change of national policy from that of high tariffs and protectionism to one of free trade. I think it would take a task force of historians, researchers and economists armed with a grant larger than the tax liability involved in this case to trace down the precise date this policy was first announced and I doubt that such a precise date would ever be established.

Sometime, probably shortly after World War II, some representative of a multinational corporation undoubtedly complained to someone in the Executive Branch of the federal government that the use of the unitary method of taxation was inconsistent with the waters-edge method used by all commercial nations and the federal government of the United States. This triggered a program that has been going on long before the taxable years in question to persuade the states to abandon that method of taxation. When was that precise date? I don't know, probably in the 1950's because the tax treaties go back that far.

Thus, the only reasonable inference I can draw is that this federal policy was adopted long before the taxable years in question. I am sure it was before the taxable years 1963-1967 in *Container*.

Last, defendant asks, if such interference does exist, which specific provisions of the Federal Constitution were violated by such interference?

Answer: the Commerce Clause and the Supremacy Clause.

The claim for refund will be allowed.

Plaintiff is to prepare a judgment carrying this decision into effect. It is suggested that counsel for plaintiff and counsel for defendant collaborate in the form of this judgment so that the appeal rights of each are protected.

DATED: 4/19/89

ROBERT GARDNER
Judge Pro Tem

APPENDIX G

RULE 29.1 LIST

COLGATE'S LESS THAN 100% OWNED SUBSIDIARIES

Subsidiary	Ownership Interest
Colgate-Palmolive Ges.m.b.H.	98.10%
Dental-Pack Industria e Comercio Ltda	50.00
Chemtech (B.V.I.) Co., Ltd.	50.00
Dentatech (B.V.I.) Co., Ltd.	50.00
Hawley & Hazel (B.V.I.) Co., Ltd.	50.00
Oraltech Company Ltd.	50.00
Gervas Brunei (Sdn. Bhd.)	59.50
Colgate (Guangzhou) Co. Ltd.	65.00
Colgate-Palmolive & CIA, en C.S.	99.00
Colgate-Palmolive del Ecuador, S.A.	73.00
Industrias Quimicas Asociados Multiquim, S.A.	73.00
Colgate-Palmolive (Eygpt) S.A.E.	91.51
Colgate-Palmolive France	99.98
Cotelle S.A.	99.94
C.P. Holding S.A.	99.76

Subsidiary	Ownership Interest
Mennen France S.A.	50.00
Societe Alta	99.76
Societe Bella	99.76
Societe Delpha	99.76
Societe Industrielle de Detergents et Applications Chimiques	34.33
Colgate-Palmolive GmbH	98.13
Dan-Chemie GMBH	98.13
Asian Pioneer Co., Ltd.	50.00
Colgate-Clorox (Far East) Ltd.	50.00
Hawley & Hazel Chemical Co. (Hong Kong), Ltd.	50.00
Hawley & Hazel Investment Co., Ltd.	50.00
Camelot Investments Co. Ltd.	40.00
Colgate-Palmolive (India) Ltd.	40.00
Jigs Investments Ltd.	40.00
Multimint Leasing & Finance Ltd.	40.00
Passion Trading & Investments Ltd.	40.00
Prudential Securities & Financial Trust Pvt. Ltd.	40.00
P.T. Colgate-Palmolive Indonesia	51.00
Mennen S.p.A.	50.00

Subsidiary	Ownership Interest
Viset SRL (formerly Viset S.P.A.)	49.00
Colgate Palmolive Cote D'Ivoire	99.17
Colgate-Clorox Malaysia SDN. BHD.	50.00
Colgate-Clorox (Malaysia) Industri SDN. BHD.	50.00
Colgate-Palmolive (Malaysia) SDN. BDH.	85.00
Colgate-Palmolive (M) Marketing SDN. BHD.	85.00
Gervas Corporation Malaysia Sdn. BHD.	59.50
Hawley & Hazel (Malaysia) SDN. BHD.	50.00
Puterang SDN. BHD.	35.00
Syarikat Tahara Sdn Bhd	85.00
Zaitun Industri Makanan SDN. BHD.	42.50
Zaitun Industri SDN. BHD.	42.50
Zaitun Marketing SDN. BHD. (formerly Zaitun Holdings SDN BHD)	42.50
Colgate-Palmolive Pakistan (formerly National Detergents Ltd.)	30.00
Colgate-Palmolive (PNG) Pty. Ltd.	49.00
Endeavon (PNG) Pty. Ltd.	49.00
Colgate-Palmolive Poland	55.00
Societe Industrielle de Bourbon	51.00
Colgate-Palmolive Romania	60.00

Subsidiary	Ownership Interest
Colgate-Palmolive Arabia Ltd.	49.00
Colgate-Palmolive Senegal	62.94
Hawley & Hazel Chemical Co., Singapore (Pte.), Ltd.	50.00
CHET Household Products (PVT) Ltd.	80.00
Hao Lai Chemical Co., Ltd.	50.00
Hawley & Hazel Taiwan Corp.	25.00
Siam Green Consumer Products, Ltd.	49.00
Siam Regal Co., Ltd.	24.50
Baser Kimya San. Ve Tic. A.S.	45.00
Baser Tuketim Maddeleri Paz, Vet Tic. A.S.	45.00
Colgate-Palmolive Haci Sakir Sabun San. ve Tic. A.S.	67.00
Gervas Corpn Int Ltd (formerly Gervas (Vanuatu) Limited)	68.00
Colgate Finance S.N.C.	99.67
Bromo Industrial	33.00